

**Michigan Department of Treasury
Tax Compliance Bureau
Audit Division**



**Contractor
Manual**

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Disclosure

This manual is not intended as a statement of law, Department policy, or of the Treasurer's official position. The information contained in this manual has been prepared as instructional text. The purpose of this manual is to explain key provisions of the General Sales Tax Act and Use Tax Act.

Any references in this manual to Rules, Revenue Administrative Bulletins (RABs), Internal Policy Directives (IPDs) and Letter Rulings are based on the most recent versions available as of the date of this edition. The materials will be reviewed regularly and revised as needed. Where changes in the law supersede and conflict with anything in this document then the new law shall control.

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Chapter 1 – Types of Contractors

Contractors include prime contractors, general contractors, subcontractors, construction contractors and contractors who manufacture, fabricate or assemble property prior to affixing it to realty. Categorization as a contractor is not dependent on governmental licensing requirements.

A contractor is generally liable for sales and use tax because he or she is the consumer of all items acquired or used in Michigan to provide his or her service, including equipment, supplies, and materials, unless a specific exemption applies. **Consumer** means a person who, for consideration, has acquired tangible personal property for storage, use, or other consumption in this state, whether acquired in person, through the mail or catalog, over the Internet, or by other means. Consumer includes, but is not limited to, one or more of the following:

- A person acquiring tangible personal property if engaged in the business of constructing, altering, repairing, or improving the real estate of others
- A person who has converted tangible personal property or services that were exempt from sales or use tax to a use that is not exempt from tax

Note that a contractor need only **acquire** tangible personal property to be subject to use tax. **Acquire** is not equivalent to ownership. The word **acquire** is defined in Black's Law Dictionary Eighth Edition to mean "to gain possession or control of; to get or obtain." Furthermore, a contractor making retail sales or engaging in manufacturing may also be subject to use tax when it removes goods from inventory for personal use or consumption, or for use or consumption in the conduct of its business. However, a use tax exemption exists for property **purchased or manufactured** by a person constructing, altering, repairing, or improving real estate for others if it is affixed to and made a structural part of real estate located in **another state**.

There are three categories of contractors:

1. Real Property Contractors:

Real property contractors are persons engaged in the business of constructing, altering, repairing or improving real estate for others to the extent that tangible personal property is affixed to and made a structural part of the real estate.

As a consumer, a real property contractor incurs sales and use tax responsibilities. Its sales and use tax obligation is generally 6% of the cost of materials used in the job.

In most cases, the tax liability is satisfied by:

- the contractor paying sales tax to its vendor, OR
- the contractor paying use tax on the property consumed

In some cases, a retailer sells a product to its customer and hires a subcontractor to handle the installation of the product (e.g., countertop). When a retailer makes a taxable sale of property to a customer it must remit sales tax, regardless of whether the retailer subcontracts with a contractor for installation of the property. If the retailer collects sales tax from its customer, the contractor will be relieved of paying use tax for that property. However, the contractor must be able to demonstrate that the sales tax was collected by the retailer. A sales invoice from the retailer to the customer that separately states the sales tax is sufficient evidence to establish that sales tax was collected on the retail sale and will satisfy the contractor's burden of proving its entitlement to the exemption provided for in the statute.

If a contractor obtains the materials for installation contracts it has with the retailer from a source that is not the retailer (e.g., a third-party vendor), the contractor would owe sales tax to that vendor unless there is a valid exemption, and that property would then be exempt from use tax upon installation.

Where a contractor is **exclusively** engaged in the contracting business and makes no direct sales to other contractors or consumers, the contractor does not need a sales tax license. Unless a contractor always pays tax at the point of purchase, the contractor is required to maintain a use tax registration and pay use tax on untaxed purchases.

2. Real Property Contractors Acting as Retailers:

Real property contractors acting as retailers are real property contractors that consistently hold themselves out to the public as retailers, and who consistently collect and remit sales tax in a manner consistent with the General Sales Tax Act. The contractor may elect to collect sales tax on the retail **sales price** of the property as long as the total sales tax remitted is not less than the sales/use tax that would have been paid on the cost of the materials. If the contractor engages in more than one distinct business activity, (e.g., repair of property and installation of property), each distinct activity may be treated differently as long as the treatment is consistently applied.

Where a contractor is **not exclusively** engaged in the contracting business but makes sales of tangible personal property at retail to other contractors and consumers, the contractor shall secure a sales tax license and file returns to report sales on such transactions. Use tax due on untaxed purchases consumed in this state in contractor operations shall be reported on the combined sales and use tax returns.

A contractor that does not usually make retail sales may be treated as a retailer in certain transactions with an agricultural producer. For example, subsurface drainage systems, land tile, and portable grain bins that are purchased and installed by a contractor for an agricultural producer are considered to be tangible personal property. Therefore, a resale sales/use tax exemption applies to the contractor's purchase. An agricultural exemption applies upon installation or transfer to the agricultural producer because the contractor is not the end user of tangible personal property.

3. Manufacturer/Contractors:

A manufacturer/contractor is a person who both:

- Manufactures, fabricates, and/or assembles tangible personal property
- Affixes that property to real estate for others (e.g., is a real property contractor)

Retail sales by manufacturer/contractors are subject to sales tax on the full sales price. The use tax obligations of a manufacturer/contractor depend upon whether it maintains an inventory of its products for sale to others or makes its product available for sale to others through a publication or price list. These requirements are described later in this manual.

Note: If a company bills “time and material” but has a subcontractor do the actual affixation to realty, the company still qualifies as a manufacturer/contractor. The subcontractor is never billed for the material; therefore, the manufacturer/contractor remains liable for any use tax due. However, if materials are billed to the subcontractor, the manufacturer is making a retail sale and does not qualify as a manufacturer/contractor. The manufacturer of those materials may still be eligible for the industrial processing exemption.

References pertaining to this information can be found in the index under [Chapter 1](#)

Chapter 2 - Real vs. Personal Property

Real property is defined in Black's Law Dictionary Eighth Edition as "land, and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land." Realty and real estate have the same meaning as real property.

To determine whether property remains tangible personal property or is made a structural part of realty, we look to three general tests:

1. Annexation to realty, either actual or constructive

This test has to do with the manner in which an item is attached to the real property. There are innumerable ways that a person can affix personal property to real estate; some items may be physically attached to the real estate (e.g., bolted to the floor or wall) whereas other items may be put in place with the intent that the property will become part of the real estate through size and character. Therefore, even if an object is not physically affixed to the realty, it may acquire the status of a fixture by constructive annexation.

There is no universal test whereby the character of what is claimed to be a fixture can be determined in the abstract and neither the mode of annexation nor the manner of use is conclusive in all cases. If the item is attached in such a manner that its removal would destroy the building, do substantial injury to the building, or impairs the property's value or the value of the realty, the item is usually held to be real property. However, whatever is affixed to a building by an owner in complement, to facilitate its use and occupation in general, becomes a part of the realty, though capable of removal without injury to the building.

The doctrine of constructive annexation has frequently been applied in the case of property which is not itself actually or directly annexed to the realty, but is part of, or accessory to, property which is annexed. The property, if removed, would leave the property to which it is annexed unfit for use and the part or accessory is not capable of general use elsewhere.

Certain equipment remains personal property even though it may appear to be part of real property. Since some items can have the appearance of being real property, it is important to ascertain all the facts before making a final decision.

If the object is not attached to the land or to some structure or appliance which is attached to the land, it will retain its character as personality even though intended for permanent use on the premises.

Generally, if property depends on the building utilities for operation and use and is connected to the building utilities (e.g. gas, electric, plumbing.), it is deemed to be affixed to realty.

2. Adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated

This test suggests that if an item functions as part of the particular building or if it carries out part of the function of the real property, that item is probably real property. An object introduced onto the realty may become a fixture if it is necessary or at least a useful adjunct to the realty, considering the purpose to which the latter is devoted. An example of this type of real property would be screens which are built to fit the windows of a particular building. Another example would be theater seats bolted to the theater floor and an essential part of the function of the building.

Another indicator of real property exists when the object cannot be used unless affixed to the building or land (e.g., night depository equipment, drive-up window equipment, vault doors and remote transaction units).

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

3. Intention to make the article a permanent accession to the freehold

Whether attached property becomes a fixture depends largely upon the intention of the parties. Objective visible facts are used to determine whether intention to make the property a permanent accession to the realty exists.

The permanence required is not equated with perpetuity. It is sufficient if the item is intended to remain where affixed until worn out, until the purpose to which the realty is devoted is accomplished, or until the item is superseded by another item more suitable for the purpose. Permanency of the attachment, and its character in law, do not depend so much upon the degree of physical force with which the thing is attached, or the manner and means of attachment, as upon the motives and intention of the party in attaching it. If the intention is that the articles attached shall not by annexation become a fixture, as a general rule they will not.

Intent may be inferred from the nature of the article affixed, the purpose for which it was affixed, and the manner of annexation. Whatever is affixed to a building by

an owner in complement, to facilitate its use and occupation in general, becomes a part of realty, though capable of removal without injury to the building.

Real vs. Personal Property Chart

No.	Description	Most likely categorization (dependent on facts and circumstances)
1	Acoustical ceilings: <ul style="list-style-type: none"> • Building ceiling construction • Portable 	Real Personal
2	Air compressors: <ul style="list-style-type: none"> • Portable • Part of central system 	Personal Real
3	Air conditioning systems for general building	Real
4	Air conditioning units: <ul style="list-style-type: none"> • Window type units • Floor or cabinet type - no ductwork • Process – central system • Evaporators 	Personal Personal Real Real
5	Air makeup unit: <ul style="list-style-type: none"> • For general building • For specific IP function 	Real Personal
6	Alarm/security systems: <ul style="list-style-type: none"> • Built-in components • Freestanding or wall-mounted components 	Real Personal
7	Appliances – built in	Real
8	Awnings – canopies/marquees	Real
9	Berms	Real
10	Bins: <ul style="list-style-type: none"> • Portable • Built-in 	Personal Real
11	Boilers: <ul style="list-style-type: none"> • One boiler • Replacement boiler • Multiple boilers 	Real Real R or P depending on use

No.	Description	Most likely categorization (dependent on facts and circumstances)
12	Booths: <ul style="list-style-type: none"> • Equipment type • Building type -- room like 	Personal Real
13	Bridges: <ul style="list-style-type: none"> • Specific to equipment • Specific to building 	Personal Real
14	Bunkers and silos	Real
15	Bus ducts: <ul style="list-style-type: none"> • For general electrical distribution • For specific equipment 	Real Personal
16	Cabinets	Real
17	Carpeting	Real
18	Catwalks: <ul style="list-style-type: none"> • Attached to equipment • Attached to building 	Personal Real
19	Central control systems: <ul style="list-style-type: none"> • Direct control specific for equipment • General control power wiring • Control building 	Personal Real Real
20	Clocks: payroll and watchman clocks	Personal
21	Combustion turbines for producing electricity at a power plant for retail sale	Personal
22	Communications systems -- permanent: <ul style="list-style-type: none"> • Phone • Pneumatic tubes 	Personal Personal
23	Compressor for general building air conditioners	Real
24	Conveyors or carrier enclosures	Personal
25	Cooling towers	Real
26	Counters and countertops	Real
27	Crane tracking or rails (crane ways)	Personal
28	Cranes	Personal
29	Dehumidifiers: <ul style="list-style-type: none"> • Portable • Part of heating air conditioning 	Personal Real

No.	Description	Most likely categorization (dependent on facts and circumstances)
30	Dikes or levees: <ul style="list-style-type: none"> • Surrounding storage tanks • River or lake control 	Real Real
31	Dock bumpers and seals	Real
32	Dock levelers	Real
33	Docks, ramps (built-in)	Real
34	Door operators	Real
35	Doors (garage and pass doors)	Real
36	Dryers, processing	Personal
37	Ductwork: <ul style="list-style-type: none"> • Building • For equipment 	Real Personal
38	Dumbwaiters	Real
39	Dust or spray collection equipment for specific machines	Personal
40	Dynamometer testing cells	Real
41	Electrical distribution materials & equipment: <ul style="list-style-type: none"> • Up to last transformer and up to the secondary substation • Installed after usable power is provided to be used for machinery and equipment 	Real Personal
42	Electrical substation enclosures	Real
43	Elevators	Real
44	Emergency lights	Real
45	Enclosures: <ul style="list-style-type: none"> • Building • Freestanding 	Real Personal
46	Energy monitors: <ul style="list-style-type: none"> • General building • For specific equipment 	Real Personal
47	Escalators – building	Real
48	Exhaust systems/air makeup units: <ul style="list-style-type: none"> • Ducted from equipment • Building ventilation 	Personal Real

No.	Description	Most likely categorization (dependent on facts and circumstances)
49	Fans: <ul style="list-style-type: none"> • Building ventilation, built-in • Portable 	Real Personal
50	Fencing	Real
51	Fireplace inserts	Personal
52	Fire protection systems: <ul style="list-style-type: none"> • Building sprinklers • Building CO₂, halon, hi-ex foam systems, • CO₂, halon, hi-ex foam system for equipment only • Supplemental water system to assist bldg. • Supplemental water system for equipment only • Fire extinguisher cabinets, reels, valves • Fire extinguishers (canister or tanks) • Fire escapes 	Real Real Personal Real Personal Real Personal Real
53	Flag poles, in ground or on building	Real
54	Floor finishes: <ul style="list-style-type: none"> • Special coverings (wood block, steel tile) • Standard coverings (carpet, linoleum, tile) 	Real Real
55	Floor grates: <ul style="list-style-type: none"> • Not adjacent to machinery • Adjacent to machinery 	Real Real
56	Flooring, raised or computer room	Personal
57	Foundations for specific IP equipment	Personal
58	Freezers: <ul style="list-style-type: none"> • Building type construction, walk-in • Portable – freestanding 	Real Personal
59	Furnaces: <ul style="list-style-type: none"> • One – new • One – replacement • For IP use – replacement • Multiple 	Real Real Personal R or P depending on use
60	Garage door openers	Real

No.	Description	Most likely categorization (dependent on facts and circumstances)
61	Gas distributions systems: <ul style="list-style-type: none"> • Gas lines to process system • Gas lines to building systems 	Personal Real
62	Gate operators: <ul style="list-style-type: none"> • Part of fence -- land improvements 	Real
63	Generator: <ul style="list-style-type: none"> • One which services the facility • Used for specific machine 	Real Personal
64	Guard rails and posts: <ul style="list-style-type: none"> • Protect equipment - attached to building • Protect equipment - attached to equipment • Protect inventory • Roads, parking, building 	Real Personal Real Real
65	Heaters: unit heaters, hanging	Real
66	Heating & venting systems (general building type)	Real
67	Hoists: built-in	Real
68	Hot water heaters	Real
69	Humidifiers: built-in	Real
70	Incinerators	Real
71	Insulation & piping in wall for refrigerated rooms	Real
72	Kilns, ceramic and lumber built-in	Real
73	Landfill cells-layers of waste separated from land by an impermeable barrier: <ul style="list-style-type: none"> • Piping/horizontal wells (in landfill cells) • Tire chips (over piping in landfill cells) 	Personal Personal
74	Landscaping materials-installed	Real
75	Lighting, electrical: <ul style="list-style-type: none"> • General building • Land improvements • Supplemental -- building system (fixtures extended down from general building) • Supplemental -- equipment (fixtures hard-wired and extended down to a specific machine) 	Real Real Real Personal
76	Lightning arresters	Real

No.	Description	Most likely categorization (dependent on facts and circumstances)
77	Loading dock	Real
78	Locker room facilities: <ul style="list-style-type: none"> • Plumbing fixtures, showers • Permanent partitions • Toilet partitions • Lockers, freestanding • Lockers, recessed into wall 	Real Real Real Personal Real
79	Office – portable	Personal
80	Operators, doors & windows	Real
81	Parking control systems	Real
82	Partitions: <ul style="list-style-type: none"> • Portable-cubicles/workstations • Permanently attached 	Personal Real
83	Pipe rack supports	Real
84	Piping: <ul style="list-style-type: none"> • From wall to specific machinery • Utility piping, gas, water, etc. 	Personal Real
85	Plastic door strips (air guard strips) to separate areas	Real
86	Plumbing: <ul style="list-style-type: none"> • General building • Plumbing, to specific equipment 	Real Personal
87	Pools: <ul style="list-style-type: none"> • In ground • Above ground 	Real Personal
88	Press pit	Personal
89	Pump houses	Real
90	Ramps: <ul style="list-style-type: none"> • Portable • Built-in 	Personal Real
91	Rooms within a plant, not a structural part of realty	Personal
92	Scale houses	Real
93	Scales: built-in	Real
94	Shed <ul style="list-style-type: none"> • Bolted to concrete slab • Portable for storage 	Real Personal
95	Siding	Real

No.	Description	Most likely categorization (dependent on facts and circumstances)
96	Signs: <ul style="list-style-type: none"> • Affixed to building • Integral part of equipment 	Real Personal
97	Silo – raw material storage	Real
98	Spray booths, permanently attached	Real
99	Stainless steel wall panels for food industry	Real
100	Tanks - built-in (attached to a building or foundation)	Real
101	Telephone wiring in wall	Real
102	Theatre seats bolted to the floor	Real
103	Toilet facilities: <ul style="list-style-type: none"> • Plumbing fixtures, showers • Partitions 	Real Real
104	Underground cables	Real
105	Vats for mixing (manufacturing process)	Personal
106	Water meters (owned by city/county)	Personal
107	Water softeners	Real
108	Wash fountains	Real
109	Welding booth, portable	Personal
110	Window shutters – decorative	Real
111	Window treatments	Personal
112	Wood blocking for floor	Real
113	Wood burning stoves, built-in and/or vented	Real

References pertaining to this information can be found in the index under [Chapter 2](#)

Chapter 3 - Statutory Exemptions

Tangible personal property acquired for affixation to, and made a structural part of, certain types of real property may be exempt. Contractors claiming an exemption when purchasing materials used in an exempt construction contract should obtain a written statement from the entity and any applicable supporting documentation. These exemptions apply to all types of contractors that affix tangible personal property to realty. There is no exemption for supplies, electricity, natural gas and other items consumed by the contractor and not affixed to realty.

Nonprofit Hospitals

The General Sales Tax Act and Use Tax Act states that tangible personal property sold to a person directly engaged in the business of constructing, altering, repairing or improving real estate for others is exempt to the extent that the property is affixed to and made a structural part of a nonprofit hospital. The statute requires that a hospital comply with the following two tests to be met in order for this exemption to apply:

- Meet the statutory definition of a nonprofit hospital, and
- Pass the inurement test

Nonprofit hospital means one of the following:

1. That portion of a building to which one of the following applies:
 - Is owned or operated by an entity exempt under Internal Revenue Code that is licensed as a hospital under part 215 of the Public Health Code
 - Is owned or operated by a governmental unit in which medical attention is provided
 - Is owned or operated by an exempt entity or entities in which medical attention is provided
2. That portion of real property necessary and related to a building described in 1 above, in which medical attention is provided.

Medical attention means that level of medical care in which a physician provides acute care or active treatment of medical, surgical, obstetrical, psychiatric, chronic, or

rehabilitative conditions, that require the observation, diagnosis, and daily treatment by a physician.

Although the statutory definition of **nonprofit hospital** includes a county long-term medical care facility, this exemption is not available after January 1, 2008.

Nonprofit hospital **does not include** the following:

- A freestanding building or other real property of a nursing home or skilled nursing facility licensed under Part 217 of the Public Health Code
- A hospice licensed under Part 214 of the Public Health Code
- A home for the aged licensed under Part 213 of the Public Health Code

Inurement of Benefit Test

Any portion of property that otherwise qualifies as a nonprofit hospital must also pass the inurement of benefit test. That is, no income or benefit may inure directly or indirectly to an individual, private stockholder or other private person from the independent or nonessential operation of that portion of the property. This exemption may be calculated on a pro rata basis.

A nonprofit hospital passing the inurement of benefit test would qualify for exemption. However, where a single building is being constructed that will have multiple uses, some of which will not pass the inurement of benefit test, that portion not meeting the test will be taxable. For example, in the nonprofit hospital context, portions of the hospital building not meeting the test include, but are not limited to, those which would be rented or provided to persons to conduct commercial activities such as:

- Physicians (for private practice)
- Pharmacy
- Gift shop
- Coffee shop
- News stand
- Medical apparatus outlet

- Cafeteria

Generally, real estate owned or operated by a nonprofit hospital entity will qualify for the contractor flow through exemption. This will include such items as parking lots (for a nonprofit hospital but not parking lots servicing a doctor's office) and structures, whether or not connected to or near the building in which medical attention is given. This will also include the **guest house** buildings but only if owned by the hospital.

Qualified Nonprofit Housing

The General Sales Tax Act and Use Tax Acts state that property used in certain improvements to real estate is exempt, including property purchased by a person directly engaged in the business of constructing, altering, repairing, or improving real estate for others to the extent that the property is affixed to and made a structural part of the real estate of a nonprofit housing entity qualified as exempt pursuant to Section 15a of the, Act No. 346 of Public Acts of 1966 (State Housing Development Authority Act, or SHDAA). Qualified nonprofit housing includes only that portion of the property of the homes or dwelling places constructed by a qualified nonprofit housing entity, the income or property of which does not directly or indirectly inure to the benefit of an individual, private stockholder or other private person.

A nonprofit housing entity must be qualified as exempt pursuant to the SHDAA. Government housing projects are generally not in compliance with SHDAA, thus tangible personal property affixed to them is taxable. If a benefit from any portion of the real estate inures directly or indirectly to an individual, private stockholder or other private person, that portion of the property would be taxed. Additionally, no direct or indirect benefit can inure to any person other than the intended qualified tenants.

Only private qualified nonprofit housing that has received an exemption certificate from the Michigan Housing Development Authority (MSHDA) qualifies for this exemption. Public nonprofit housing is not covered by MSHDA and therefore does not qualify for exemption.

Sanctuary

The General Sales Tax Act and Use Tax Act state that tangible personal property purchased or acquired by a contractor for affixation to the **sanctuary** portion of a regularly organized church or house of religious worship is exempt from sales and use tax. The sanctuary must be owned, occupied and used by a religious organization qualified under IRC § 501(c)(3). Sanctuary includes a sanctuary to be constructed that will be owned, occupied, and used by a religious organization qualified under IRC § 501(c)(3). The exemption is limited to building portions predominately and regularly used for public worship service.

Predominant use means that public worship occurs more than 50% of the time that the building portion is in use (includes storage). **Regular use** means normal or usual periodic use or uniform use of that portion of the building.

As used in this section, a sanctuary is limited to:

1. Portions of a building where the acts of worship take place, including areas where the public participates in worship, areas dedicated to individual worship (such as chapels), and those portions of the building whose sole use and function is directly related to the act of public worship.
 - These areas may also include:
 - Sacristy or similar area adjacent to room where public worship services are conducted
 - Areas where consumables are prepared for use in worship service
 - Vestry or similar area adjacent to room where public worship is conducted or where clergy or other religious leaders prepare for worship service
 - Does not include areas for:
 - Social functions
 - Schooling
 - Day care
 - Religious Education
2. Portions of a building structurally necessary (directly connected) to the portion of the building where worship takes place.
 - These areas may include:
 - Foundations, including basement walls which support the interior worship area
 - Exterior walls and finishing materials directly adjacent to worship area

- Interior walls, floors and ceilings facing the interior ceiling area
- Roofs directly over the interior worship area
- These areas would **not** include:
 - That portion of exterior walls, foundations and roofs that extend beyond the interior worship area
- These areas may be apportioned:
 - Roofs not directly over interior worship area (i.e., roof over second story office above interior worship area)
 - Structural necessities supplying heat, ventilation and air conditioning to qualified sanctuary and non-exempt areas
 - Material purchases for multiple use areas in lieu of accounting for actual cubic yards of concrete or squares of roof shingles directly under or over the sanctuary

Enterprise Zone

The General Sales Tax Act and Use Tax Act state that a sale of tangible personal property to be used in a qualified business activity of the purchaser is exempt from sales tax. Tangible real or personal property is also exempt from use tax to the extent that the property is used in a qualified business activity of the purchaser. As used in this section, **qualified business activity** means activity as defined in the Enterprise Zone (EZ) Act. A contractor claiming this exemption must be qualified to operate within the Enterprise Zone and **directly** engaged in the business of affixing to realty. In addition, the affixation to realty must occur within the Enterprise Zone. Currently there are no active state enterprise zones in Michigan, and new zones are not being designated.

The City of Benton Harbor is a Federal Enterprise Zone, but this classification does not provide any exemption from sales or use tax. Future developments related to state enterprise zones should be confirmed with the Michigan Economic Development Corporation (MEDC).

Qualified Water or Air Pollution Control Facilities

The General Sales and Use Tax Acts allow an exemption for the sale or purchase of tangible personal property to be installed as a component part of a water or air pollution control facility. The exemption is dependent on a tax exemption certificate issued by the State Tax Commission. Issuance of a certificate is contingent upon satisfying the conditions found in the Natural Resources and Environmental Protection Act, Act No. 451 of the Public Acts of 1994.

The pollution control exemptions in the Sales and Use Tax Acts are interpreted in 1979 AC, R 205.137, *Air and Water Pollution* as follows:

1. Tangible personal property purchased for installation as a component part of an air or water pollution control facility for which the State Tax Commission issues a tax exemption certificate is exempt from tax.

The certificate describes the property that qualifies for tax exemption. It includes items that become part of real property. **The flow through exemption applies when the contractor purchases exempt personal property for these pollution control projects.**

2. When tax has been paid on tangible personal property which later qualifies for exemption as a result of obtaining a certificate of exemption from the State Tax Commission, a refund may be requested by the purchaser upon submission of both of the following documents to the Department of Treasury:
 - A copy of the exemption certificate issued, indicating the approved cost of the tangible personal property installed and entitled to exemption
 - A copy of the seller's invoice showing the name and address of the seller, identification of the purchaser, identification of the items purchased, date of purchase and amount of tax paid to the seller

To facilitate the refund process, the owner of the pollution control facility can provide the Department's Tax Processing Division with a copy of the Pollution Control Exemption Certificate, together with a list of vendor invoices qualifying for the sales tax credit. That division will respond with approval or disapproval to facilitate the refund process.

Pollution Control Exemption Certificates and Limitations

An entity must apply for and be granted a pollution control exemption certificate by the Michigan State Tax Commission before any of its purchases qualify for this exemption. The effective date of the certificate is the date of issue and the certificate continues in force until it is revoked or the facility is no longer used for its primary purpose. The certificate will state the total cost of the property entitled to exemption. If the final cost of material in the pollution control facility exceeds this amount, amounts exceeding the limitation are subject to tax. Furthermore, replacement equipment and repair parts acquired in subsequent years may be taxable items if the additional costs would cause the project to exceed the stated exempt value in the original exemption certificate.

If the State Tax Commission, through a pollution control exemption certificate, states that certain property is exempt from sales and use taxes, it is exempt. However, even if a certificate is granted for the pollution control facility, the pollution control facility exemption is **limited** in scope to property purchased/sold and installed **as a component part** of such a facility. Thus, not all property which may be associated with the construction, installation, etc. of a pollution control facility qualifies for the exemption. Equipment benefiting the business or personnel will be taxable. Examples include, but are not limited to, heat recovery equipment, air make-up units, equipment used to prepare and return contaminants to the process, etc. The utility costs associated with the operation of these facilities also do not qualify for the exemption.

State/Tribal Tax Agreements

Certain tax exemptions may apply to contractors that enter into contracts involving federally recognized Indian Tribes (and their qualifying members) that have an effective tax agreement with the State of Michigan.

Materials that are purchased, used or acquired in the performance of a contract entered into by a Resident Tribal Member, Tribe, or Tribal Entity for construction, renovation or improvement of real property owned by the Tribe or the federal government in trust for the Tribe are exempt from both sales and use taxes if the real property is located within the Tribal and Trust Lands and there is no contractual entitlement for a non-Resident Tribal Member or non-Tribal Entity to remove the improvement.

Materials that are purchased, used or acquired in the performance of a contract for construction, renovation or improvement to the principal residence of a Resident Tribal Member are exempt from both the sales tax and use tax.

Where the Tribe requesting exemption has opted for the certificate method, the contractor must secure a Tribal Certificate of Exemption (TCE), and a copy of the Letter

of Authorization issued by the Department to the Tribe. The contractor presents this information to the vendor to purchase materials tax-free. Where the contractor is a subcontractor not identified on the TCE, a Michigan Sales and Use Tax Exemption Certificate must be completed by the sub-contractor and provided to the vendor in addition to the TCE and Letter of Authorization.

Tribes with State/Tribal Tax Agreements are listed on the Michigan Treasury Website. These agreements dictate the terms of the exemptions for the Tribes and their qualifying members for those taxes covered under the Tax Agreement(s). State law applies to those taxes where not otherwise altered by the Tax Agreement(s).

Note: Contractors engaged in the construction of Tribally-owned facilities (e.g., casinos) could qualify for an exemption if all of the following criteria are met:

- The facility is constructed on Tribal and Trust Lands
- The Tribe has an effective tax agreement with the State
- The construction contract does not entitle anyone other than the owner (e.g., Tribe, Resident Tribal Member or Tribal Entity) to remove the facility or improvement
- The documentation identified above is completed and used appropriately

Qualified Convention Facility

Effective 3/25/2014, the General Sales Tax Act exempts the sale before January 1, 2016 of tangible personal property for use in construction or renovation of a qualified convention facility under the Regional Convention Facility Authority Act, 2008 PA 554. There is also a use tax exemption (effective 1/20/2009) for tangible personal property acquired before January 1, 2016 by a person engaged in the business of altering, repairing or improving real estate for others if the property is to be affixed to or made a structural part of a qualified convention facility under the Regional Convention Facility Authority Act. A **qualified convention center** means that term as defined in MCL 141.1355.

References pertaining to this information can be found in the index under [Chapter 3](#)

Chapter 4 - Manufacturer/Contractors

Use Tax Treatment

If a manufacturer/contractor

- Maintains an **inventory** of its product(s) available for sale to others,
- OR
- Makes its product available for sale to others by **publication** or **price list**,

The use tax base for products withdrawn from inventory and affixed to realty in Michigan is **finished goods inventory value** as outlined in 26 CFR 1.471-11. The manufacturer/contractor's equipment and supplies will qualify for the industrial processing exemption if they are used in the industrial process. Tools used at the construction site do **not** qualify for exemption unless used to mix, blend, etc.

If a manufacturer/contractor

- Does **not** maintain an **inventory** of its product available for sale to others,
- AND
- Does **not** make its product available for sale to others by **publication** or **price list**,

The use tax base for products withdrawn from inventory and affixed to realty in Michigan is the sum of the cost of **direct materials** and **direct labor** to manufacture, fabricate, or assemble the property. The components of direct materials and direct labor are discussed in 26 CFR 1.471-11 and the related statutes. The manufacturer/contractor's equipment and supplies do **not** qualify for the industrial processing exemption.

The words **fabricate**, **manufacture**, and **manufacturer** are defined by statute at MCL 205.93a(5). The Department defines **assemble** as to gather into a group or collect or to fit or put together the parts of.

- **Direct Labor**

Direct labor pertains to staff directly engaged in production, including manufacturing or fabricating (including mixing, combining, or blending) at the job site prior to affixation, operating fabricating machines, and in-process material handling. Costs of direct labor include:

- Wages
- Fringe benefits
- Accident, health, long-term disability, and life insurance plans
- Bonuses, commissions, stock bonuses, profit sharing
- Workers' compensation
- Pension and retirement
- Payroll taxes
- Any other payment incurred on behalf of employees directly engaged in production

Direct labor **does not include** staff performing shipping and receiving, shop supervision, or maintenance and repair functions. In addition, direct labor to cut, bend, assemble or attach at the job site in Michigan is specifically exempted from the use tax base by statute. However, these costs would be part of the cost of labor to manufacture if performed at the taxpayer's location or other non-job site location. In general, the cost of labor to "cut, bend, or assemble ... property at the site for affixation" relates to the cost of labor at the job site to make minor adjustments, alignments, alterations and other changes which are necessary in order to affix the property to real estate in Michigan. For example, incidental mixing such as the mixing of mortar and tinting of paint at the job site need not be included in the use tax base. In contrast, costs of labor incurred at the job site in Michigan (other than to cut, bend, assemble or attach) which fall within the definition(s) of **manufacture** and/or **fabricate** under MCL 205.93a(5) are included in the use tax base. For example, costs of labor at the job site for mixing, combining or blending prior to affixation of property will be included in the use tax base.

- **Direct Materials**

Direct materials include raw materials, supplies entering into or consumed in connection with the product, and costs incurred to move the material to the point of manufacturing.

The cost of a sub-processing activity by an outside party is also included in the cost of material for determining the use tax base. It does not matter if the sub-processing occurs before or after the transfer of ownership to or possession by the manufacturer/contractor.

- **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. Indirect production costs are included **only to the extent** that such costs are incident to and necessary for production or manufacturing operations or processes. These indirect production costs include repairs and maintenance, utilities, rent, indirect materials and supplies, tools and equipment that are not capitalized, and costs of quality control and inspection. Indirect labor and production supervisory wages are also included. In addition, certain other costs may be includable depending on the way they are treated in the taxpayer's financial reports.

Finished goods inventory value generally **does not include** costs of marketing, research and development, or sales. It also excludes general and administrative expenses and officer salaries that are incident to and necessary for the taxpayer's activities taken as a whole rather than incident to and necessary for production or manufacturing operations or processes.

Under Michigan law, costs of labor to cut, bend, assemble or attach tangible personal property at the job site are also excluded from finished goods inventory value.

- **Inventory**

The following criteria are used to determine if a taxpayer maintains an inventory of its product(s) available for sale to others:

1. The inventory must be similar to the product that it affixes to realty. For example, a countertop manufacturer/contractor might have a retail inventory of shelving that it sells to walk-in customers, though it custom makes countertops to order. This fact would not require the contractor to

pay use tax on the finished goods inventory value of the installed countertops.

2. The inventory does not have to be a completely finished product 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.
3. The retail sale of related products should be more than de-minimus.
4. A book or tax accounting inventory is not a requirement, only the existence of an actual physical inventory.

- **Price List**

A numerical or alphabetical enumeration of goods, wares, merchandise items or services, quoting wholesale and/or retail prices and presented, maintained or otherwise displayed in any written or electronic form. A price list includes, but is not limited to, printed cards or sheets, an erasable board in a sales room, or an Internet website.

- **Publication**

Includes, but is not limited to, a **catalog**, **sales pamphlet** and **sales handbill** or pricing on an Internet website.

Catalog: A bound, stitched, sewed or stapled book or pamphlet, or document maintained in electronic format (e.g., hard drive or Internet), containing a list and description of goods, wares, merchandise or services with specific information, with or without a price.

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

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

Note: A publication or price list must reflect the amount charged for tangible personal property and not an installed total. It also must reflect a finished goods price (not cost of raw material).

Example 1:

A manufacturer/contractor enters into a contract to build a house. In its 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** and/or the assembly of the trusses falls within the definition of **assemble**.) However, the cost of labor incurred at the job site to cut, bend, assemble, or attach the trusses to the real estate are not included in the use tax base.

Example 2:

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 with 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, or attach the cabinets to the real estate are not included in the use tax base.

Example 3:

A manufacturer/contractor fabricates and installs steel beams. Engineering/detailing costs that are related to manufacturing should be included in direct material costs under both tax-treatment options. This would include the cost of blue prints, certification tests, and architectural design costs, whether done in-house or by an outside company. These costs would be part of the direct material costs because they are necessary to determine what material to purchase for the job (what strength or grade of steel).

Example 4:

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

Example 5:

An asphalt manufacturer/contractor uses the asphalt removed from the current road bed in the production of the new asphalt. The cost of transporting this recycled asphalt product to the asphalt plant should be included in direct material costs as freight-in. This computation would also include depreciation, oil, gas and maintenance of the roto mill, as well as the labor costs of the roto mill operator. These costs would be included under both tax-treatment options. The labor cost of the truck driver transporting the product to the plant would be a part of finished goods inventory value, but would not be a direct labor cost.

Other Activities of Manufacturer/Contractors

A manufacturer/contractor can be engaged in more than one distinct business activity. In these situations, the use tax base would depend on the circumstances for that particular part of the business. The availability of the industrial processing exemption for equipment and utilities would vary as well.

Example 1:

ABC Company purchases kitchen cabinets for retail sale and acts as the contractor when installing the cabinets. ABC's use tax base when acting as the contractor is the material cost. In this situation ABC Company is acting as a retailer and is not entitled to the industrial processing exemption.

Example 2:

ABC Company also manufactures a custom cabinet for the bathroom and maintains an inventory of its manufactured cabinets. If it needs additional cabinets, it purchases a standard cabinet for installation from an outside source. Its cost, when acting as a contractor, is the **finished goods inventory value** on the cabinets that it manufactured and material cost (at the purchased price which includes freight) on the cabinets that it purchased. ABC Company is entitled to the industrial processing exemption on the cabinets manufactured for retail sale or used in contracts.

Example 3:

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

Michigan. Furthermore, ABC Company is not entitled to the industrial processing exemption if it affixes all the custom hardwood flooring that it manufactures to real estate in Michigan. However, if it makes retail sales of the custom flooring, it is entitled to the exemption based on a percentage determined by comparing the retail sales to the contract sales. It would also be entitled to the industrial processing exemption for the hardwood flooring if installed to real estate located in another state.

Example 4:

The use tax base for a contractor who withdraws gravel from its own pit for use in a paving contract and not for resale would be zero. The labor to extract would not be included. This taxpayer would be considered a contractor, not an extractor, since the gravel extracted is not for resale.

Example 5:

If gravel is withdrawn from the pit of another for use in a contract, the cost for use tax purposes would be the amount paid to the pit owner for the material. The labor to extract would not be included. In this case, the taxpayer would be considered a contractor, not an extractor.

Example 6:

If a taxpayer bought a sand hill and used the sand to make glass to install in a building, the use tax base would be the cost of the material. This taxpayer is a manufacturer/contractor, not an extractor. If the taxpayer also sold sand at retail, it would also be an extractor.

Example 7:

If an extractor/manufacturer/contractor maintained a standard inventory of aggregate for sale to others, the use tax base when using aggregate in performance of a contract would be the finished goods inventory value – whether or not extracted from the extractor/manufacturer/contractor's own pit or the pit of another.

References pertaining to this information can be found in the index under [Chapter 4](#)

Chapter 5 - Industrial Processing by Manufacturer/Contractors

Tangible personal property that becomes:

1. An ingredient part or component part of the finished product to be ultimately sold at retail;

OR

2. An ingredient part or component part of tangible personal property that is permanently affixed to and made a structural part of real estate located in another state,

is eligible for an industrial processing exemption. If the product is available for ultimate sale at retail to others, the industrial processing exemption applies even if the manufacturer/contractor removes the product from inventory and affixes it to (and makes it a structural part of) the real estate of another so long as the real estate is located outside of Michigan. 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. 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.

Tangible personal property permanently affixed and becoming a structural part of real estate ***in this state*** is not eligible for the industrial processing exemption. 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.

Reference pertaining to this information can be found in the index under [Chapter 5](#)

Index of References

Chapter 1 – Types of Contractors:

- 1979 AC, R 205.71, *Contractors*
- MCL 205.92(g)
- 2013 AACS, R 205.8(1)-(2), *Consumer; use; conversion*
- MCL 205.94(1)(z)
- MCL 205.94(1)(a). See LR 2014-1.
- MCL 205.93a(1)(f)(g)
- MCL 205.54a(1)(e)
- MCL 205.94(1)(f)
- RAB 1993-5, *Use Tax Base of Tangible Personal Property Affixed to Real Estate By a Manufacturer/Contractor.*

Chapter 2 – Real vs. Personal Property:

- None

Chapter 3 – Statutory Exemptions:

- RAB 1999-2, *Sales and Use Taxation in the Construction Industry.*
- MCL 205.54w
- MCL 205.94s
- MCL 333.21501-333.21571
- IRC § 501(c)(2) or (3)
- MCL 205.54w(3)(c)
- Part 217 of the Public Health Code
- Part 214 of the Public Health Code
- Part 213 of the Public Health Code
- MCL 205.54w(1) and (2)
- MCL 205.94s(1) and (2)
- Section 15a of Act No. 346 of Public Acts of 1966 (SHDAA)
- MCL 205.54p
- MCL 205.94m
- IRC § 501(c)(3)
- MCL 205.54j
- MCL 205.94h
- Enterprise Zone (EZ) Act
- RAB 1993-10, *Enterprise Zone Act Sales and Use Tax Exemptions and Single Business Tax Credit*

- MCL 205.54a(1)(l)
- MCL 205.94(1)(s)
- Natural Resources and Environmental Protection Act, Act No. 451 of the Public Acts of 1994
- 1979 AC, R 205.137, *Air and Water Pollution*
- Michigan State Tax Commission Air Pollution Control and Water Pollution Control Reports
- RAB 1990-2, *Sales and Use Taxes-Storage Facilities*
- MCL 205.30c(12)
- State/Tribal Tax Agreements and Amendments
- MCL 205.54d(m)
- MCL 205.94z
- Regional Convention Facility Authority Act, 2008 PA 554
- MCL 141.1355

Chapter 4 – Manufacturer/Contractors:

- 26 CFR 1.471-11
- MCL 205.93a(5)

Chapter 5 – Industrial Processing by Manufacturer/Contractors:

- MCL 205.94o(4)(a) and (7)(a)
- MCL 205.94o(2)
- MCL 205.94o(5)(a)

Other Related Citations:

- 1979 AC, R 205.71, *Contractors*
- 1979 AC, R 205.80, *Florists & Nurserymen*
- RAB 1988-35, *Carpeting*
- RAB 1993-5, *Use Tax Base of Tangible Personal Property Affixed to Real Estate by a Manufacturer/Contractor*
- RAB 1994-3, *Sales and Use Tax Application for Real Property Construction Contracts Offered/Made Before March 15, 1994 and Accepted Before June 15, 1994, and Bona Fide Sales or Lease Agreements Made Before March 15, 1994*
- IPD 2004-7, *What is a “County Long-Term Medical Care Facility”*
- IPD 2005-3, *Real Property Contractors Acting as Retailers*
- LR 70-5, *Contractors/Furniture and Equipment*
- LR 74-5, *Contractors/Railroads*
- LR 80-3, *Medical Equipment and Appliances*
- LR 88-13, *Contractor - Subcontractor Relationships*
- LR 88-53, *Security Monitoring System*

- LR 89-63, *Contractor as Retailer*
- LR 89-71, *Construction Contractor*
- LR 90-24, *State Government Contracts*
- LR 2014-1, *Sales and Use Tax Treatment of Subcontractors for Retailers*