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TAXABILITY OF DELIVERY CHARGES UNDER THE MICHIGAN SALES AND USE TAX

INTRODUCTION

Sales tax is applicable on the sale of tangible personal property at retail.¹ Sales tax is not applicable on the sale of services where there is no transfer of ownership of tangible personal property.

Where a sale includes both the taxable transfer of ownership of tangible personal property and the performance of tax exempt services, a single mixed transaction, the Supreme Court has provided a six part test, the incidental to service test, to determine if the transaction is a tax exempt service or the taxable sale at retail of tangible personal property.²

The General Sales Tax Act recognizes that a taxpayer may be engaged in both taxable sales as well as nontaxable sales and provides that the entire transaction will be subject to sales tax unless the taxpayer's books separately identify the taxable and nontaxable sales.³

The sales tax base is defined by statute to be "gross proceeds" as "sales price" and includes the total amount of consideration without any deduction for services incurred before the transfer of ownership of the property.⁴

In 2004, Public Act 173, effective September 1, 2004, amended the General Sales Tax Act to include in sales price delivery charges incurred before the completion of the transfer of ownership of tangible personal property. The same amendment also provided that a seller is not subject to sales tax for delivery charges allocated to the delivery of exempt property.⁵

"Delivery charges" means charges by the seller for preparation and delivery to a location designated by the purchaser of tangible personal property or services. Delivery charges include, but are not limited to, transportation, shipping, postage, handling, crating, and packing.⁶

¹ MCL 205.52(1)

² *Catalina marketing Sales Corporation v Michigan Department of Treasury*, Michigan Supreme Court Docket No. 121673 and No. 121674

³ MCL 205.52(3)

⁴ MCL 205.51(1)(d)(ii)

⁵ MCL 205.51(1)(d)(v)

⁶ MCL 205.51a(e)

There are two critical determinations which must be accurately determined before a correct determination of tax base and sales tax can be determined. The first is at what point does a transfer of ownership occur and to what extent the taxpayer is engaged in a separate nontaxable activity.

Transfer of Ownership

For purposes of this RAB, the statutory phrase “transfer of ownership” is synonymous with the term “transfer of title” used in the Michigan Uniform Commercial Code and the courts.

The legal question is whether legal title or ownership to tangible personal property passes from the seller to the customer at the sellers shipping dock or upon receipt by the customer. If title passes at the shipping dock, the delivery charges are not included in the sales tax base. If title or ownership passes upon receipt by the customer, then the delivery charges are included in the sales tax base.

The Michigan Uniform Commercial Code⁷ specifies that title to the goods pass from the vendor to the customer at that time when all the conditions for the sale have been completed. This determination is factually based and should include a complete review of not only the sellers books and records, but also the purchasers books and records.

The key factual determination is the obligations of the seller and at what point of time the seller completes its obligation to the purchaser. Is the seller obligated to deliver the tangible personal property to the purchaser at the purchaser’s place of business or other location designated by the purchaser?

Delivery by the United States Postal Service or a Common Carrier

The Michigan Supreme Court has held that title to tangible personal property transfers from the seller to the purchaser when the seller delivers the property to a common carrier for shipment to customers.⁸ Therefore, the delivery charges on tangible personal property shipped to the customer by common carrier is not included in the sales tax base.

Obligations of the Seller

The issue involves the seller’s obligation as to when and at what point title to property or ownership transfers from the seller to the purchaser. If title or ownership transfers prior to the point and time the property is placed for delivery, then the delivery charge is not included in the sales tax base. If title

⁷ MCL 440.2401 The Michigan Uniform Commercial Code (Act 174 of 1962) determines at what point a title to goods pass from the seller to the purchaser. Section 2401, Subsection (2) states that "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance ..."

⁸ *World Book, Inc. v. Revenue Division, Department of Treasury, State of Michigan*. Supreme Court of Michigan, No. 109841, 459 Mich. App. 403, 590 N.W.2d 293, March 30, 1999. Appeal from Michigan Court of Appeals, No. 184804 (222 Mich App 203; 564 NW2d 82) It was held that title to the books transferred to the purchasers in Illinois when the seller delivered them to a common carrier for shipment to customers in Michigan.

or ownership transfers at the point and time the property is physically delivered to the customer, then the delivery charge is included in the tax base. There are no judicial decisions based on pre 2004 law. However, the courts have addressed the transfer of title or ownership issue in other contexts and have provided guidance on factors to be considered.

Courts have considered the location of transfer of title, possession, risk of loss, delivery. Although the statute imposes the sales tax on the transfer of “ownership,” there is no authority to support the imposition of sales tax merely by delivery of documents of title, or by execution of a sales contract in Michigan, regardless of where the property is delivered or used. Transfer of ownership is determined by transfer of title and possession. Transfer of possession is determined by actual physical possession or constructive possession through an agent or representative.⁹

Under Michigan law, title passes to the buyer at the time and place at which the seller completes his performance¹⁰ with reference to the physical delivery of the goods.¹¹

Books, Records and Documents to Determine Seller’s Obligations of Sale

The General Sales Tax Act creates a rebuttable presumption that “all delivery charges” are included in the sales tax base.¹²

If the seller determines that the delivery charges are not included in the sales tax base, then the burden of proof falls on the seller, based on the seller’s books and records to document that the seller’s obligation of the sale is completed before delivery charges are incurred.¹³ Such books and records may include, but are limited to, the following books, records and documents that may be created, executed and preserved by the seller as well as the purchaser.

1. Purchase orders
2. Request for proposal
3. Bid documents
4. Purchase contracts
5. Sales invoices
6. Sales contracts
7. Job budget worksheets
8. Correspondence including letters, emails fax transmissions

Engaged Simultaneously in a Non Taxable Business

The General Sales Tax Act recognizes that a taxpayer may be engaged in selling both taxable sales of tangible personal property as well as nontaxable sales of services.¹⁴ If the service component of a

⁹ *Florida Leasco, LLC v. Michigan Department of Treasury*, Michigan Tax Tribunal, No. 264860, November 23, 2005

¹⁰ MCL 440.2401(2)..

¹¹ *Jerry McCarthy Highland Chevrolet v Dep't of Revenue*, 351 Mich 558; 88 NW2d 383 (1958)

¹² MCL 205.51(1)(d)(iv)

¹³ MCL 205.52(3)

¹⁴ MCL 205.52(3)

transaction (delivery services), which includes the sale of tangible personal property, is negotiated and contracted separately and charged a separate price, then the service charge is not subject to the sales tax.¹⁵ The delivery charge must be separately billed to the customer as a separately itemized item or on a separate bill or invoice. The delivery charge is a separate commercial endeavor if the delivery charges are at the market rate.¹⁶ The delivery component of the business must not necessarily show a profit.¹⁷ The service business must be engaged in a business with the object of gain, benefit, or advantage, either direct or indirect.¹⁸

The General Sales Tax Act provides that the entire transaction will be subject to sales tax unless the taxpayer's books separately identify the taxable and nontaxable sales.¹⁹

When determining the taxability of delivery charges, the taxpayer must consider all of the facts and circumstances surrounding the retail business activities.

A retailer will be deemed simultaneously engaged in a separate delivery service business that is not taxable if all of the following conditions are met:

1. The customer has the option to arrange their own delivery, either pick up or have the merchandise delivered by the seller. (thus, the delivery service is not always necessary to complete the transfer of tangible personal property or the performance of the transaction);
2. The delivery service charge is separately negotiated and contracted for on a competitive basis and is not a cost in calculating the merchandise price, as the customer pays a separate price (thus, the delivery service charge is not incidental to the purchase price – demonstrating a separate service transaction);
3. The taxpayer's books and records separately identify the transactions used to determine the tax on the sale at retail; and,
4. Delivery service records show or display the sellers intent to earn a profit (thus, the delivery service has evidence of a separate competitive, commercial endeavor).

All four conditions must be met for the seller to be considered simultaneously engaged in a nontaxable delivery service.

Delivery charges on merchandise delivered by a seller who is not engaged in a separate delivery service business as defined above are taxable if the charges are incurred prior to the transfer of ownership. Delivery charges are not taxable if incurred after the transfer of ownership.

¹⁵ *National Aggregates Corporation v Michigan Department of Treasury*, 133 Mich App 441; 350 NW2d 272 (1984); lv den 419 Mich 949 (1984)

¹⁶ *Margaret H. James, Ltd. v Michigan Department of Treasury*, Court of Appeals, Unpublished Opinion No. 132896 (June 26, 1992)

¹⁷ *Viviano Flower Shop, Inc. v Michigan Department of Treasury*, Michigan Tax Tribunal, Docket No. 252577, August 1, 2002.

¹⁸ MCL 205.51(1)(e)

¹⁹ MCL 205.52(3)

Other Services

Generally, the sales tax is not imposed on services.²⁰ The sales tax base is defined by statute to be “gross proceeds” as “sales price” and includes the total amount of consideration without any deduction for services incurred before the transfer of ownership of the property.²¹ Therefore, any services performed or completed before the transfer of title and ownership of the property is included in the sales tax base. Such services may include, but are limited to, handling charges, packaging charges, postage, crating, labeling charges, and all other charges incurred before the transfer of title and ownership of the property. All such services are included in the sales tax base even if the delivery charge is not included in the tax base. If the invoice to the customer does not separate the services from the delivery charge, then the entire amount of the charge is subject to tax.²²

Non Taxable Sales

A seller is not liable for delivery charges allocated to the delivery of exempt property.²³ On a sale of tangible personal property, which is otherwise exempt, the delivery charges associated with the delivery of the property are not included in a sales taxable base.

Direct Mail

“Delivery charges” do not include charges for delivery of direct mail if the charges are separately stated on an invoice or similar billing document given to the purchaser.²⁴

²⁰ MCL 205.52(1)

²¹ MCL 205.51(1)(d)(ii)

²² MCL 205.52(3)

²³ MCL 205.51(1)(d)(iv)

²⁴ MCL 205.51a(e)