

Contractor vs. Retailer

A very critical determination in the computation of tax base involves the categorization of a taxpayer as either a contractor or retailer. This determination can be critical when the application of one of the sales tax or use tax exemptions is applicable.

Both the Michigan sales tax act and the Michigan use tax act provide exemptions for the purchase of tangible personal property when that tangible personal property is used or consumed by an industrial processor or an agricultural producer. Both acts also provide exemptions from the purchase of tangible personal property for use or consumption by a church, school, governmental organization, or non-profit organization. In all instances, the exemption only applies to the purchase of tangible personal property at retail.

If the tangible personal property involved does not qualify as a retail sale, that is, the seller is acting as a contractor, the exemption would not apply and the tangible personal property would be subject to the full 6% tax.

Contractor Defined

Neither the Sales Tax Act nor the Use Tax Act specifically defines a "contract" or a "contractor". However, indirectly it is defined in sections that provide exemptions. Contractors are "persons engaged in the business of constructing, altering, repairing or improving real estate for others when the material so purchased by such persons is affixed and made a structural part of the real estate or used and completely consumed in the fulfillment of a single contract ... (MCL 205.54c)

"Contractor" includes only prime, general, and subcontractors directly engaged in the business of constructing, altering, repairing, or improving real estate for others. Contractors are consumers of the materials used by them. All sales to or purchases by contractors of tangible personal property are taxable, except when affixed and made a structural part of real estate for a qualified exempt nonprofit hospital, a nonprofit housing entity qualified as exempt under the sales and use tax acts, a church sanctuary or a certified exempt pollution control facility. All materials consumed in the performance of such contracts and not affixed and made a structural part of real property are taxable. (Rule 205.71)

In order for a taxpayer to be determined to be a contractor, and lose the advantage of certain tax exemptions, the taxpayer must both affix tangible personal property to real estate and make the tangible personal property a structural part of the real estate. Other than that which was mentioned above, neither the Michigan sales tax act nor the Michigan use tax act contain a specific definition of what constitutes a contractor. The determination is usually made in the negative. That is, the statute and the

definitions of a retail sale. A transfer of property may be determined to be not a retail sale but rather a consumption of tangible personal property by a construction contractor.

The Michigan Supreme Court opinion in the case of *Sequist vs. Fabiano* has laid out three general tests to determine realty.

1. Annexation to realty either actual or constructive. The court requires that the tangible personal property not only be attached to or affixed to the real estate, but that the annexation to the real estate is actual or constructive.
2. Adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated. The court requires that the tangible personal property, which has been affixed to realty, takes on a purpose or function that is in common with the adaptation or application of the realty itself.
3. Intention to make the article a permanent assession to the freehold. All the facts and circumstances of the case must lead to the conclusion that the tangible personal property is a permanent part of the real estate and was intended to be so. The tangible personal property can easily be removed and if in fact is done so, then the implication of the courts opinion is that the property would retain its personal property nature.

Retailer

The term "retailer" involves all persons who sell to the last or final buyer, user or consumer.

The term "sale at retail" means any transaction by which is transferred for consideration the ownership of tangible personal property, when such transfer is made in the ordinary course of the transferors business, and is made to the transferee for consumption or use, or for any other purpose than for resale in the form of tangible personal property.

The "consumer" means the person who shall have purchased tangible personal property for storage, consumption or use. The "consumer" is clearly defined as a person who does not purchase goods for sale. The buyer, who disposes of goods in any other manner than by resale, becomes the final consumer. (Rule 205.8)

The general construction of the Michigan Sales Tax Act and the Michigan Use Tax Act specifies that where a taxpayer acquires tangible personal property to be used or consumed in the performance of a construction contract, that taxpayer is the consumer of the tangible personal property. Any sales of tangible personal property to become affixed to or become a structural part of real estate are a sale to the ultimate consumer.

Tax Base

Controversies evolve when a potential tax exemption is at stake.

A "contractor" is considered to be the consumer of all tangible personal property, that is, all materials, supplies, and equipment used or consumed in performing that contract. The tax base for the contractor that is not a manufacturer/ contractor is the purchase price of all the materials, supplies, machinery and equipment purchased.

A "retailer" making a sale and transferring tangible personal property to the final and ultimate consumer is responsible to pay the 6% Michigan sales tax on the total gross proceeds, without any deduction therefore, derived from the sale of tangible personal property. The term "gross proceeds" is defined to mean the total of all sales made during a given month or period. It also means the amount received or to be received in money, credits, subsidies, property or other monies worth for the consideration of sales at retail within Michigan, without any deduction whatsoever.

If the purchaser of tangible personal property at retail qualifies as an industrial processor, or an agricultural producer, or if the tangible personal property purchased is to be used or consumed by a church, school, hospital, governmental agency, or non-profit organization, then the purchase can be made tax-free if the purchaser renders to the seller a valid exemption certificate. These exemptions are invalid if the seller is acting as a contractor and affixing the tangible personal property to the reality to which it becomes a structural component thereof.

Audit Issues

Because of new technology and the changing nature of business, the determination of Michigan tax base may also be changing. It is very important for taxpayer's, as they acquire tangible personal property for use or consumption in their businesses, to keep in mind the tax base issues involved with the purchase. It is very important that taxpayer's are competent in the Michigan sales tax and Michigan use tax issues involved with the acquisition of tangible personal property.

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