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BILL ANALYSIS

Senate Fiscal Agency

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Senate Bill 323 (as enrolled)

Sponsor: Senator Doug Carl

Senate Committee: Finance

House Committee: Taxation

Date Completed: 7-14-87

RATIONALE

Under the Use Tax Act property sold to a person for use or consumption in industrial processing is exempt from the use tax. Although "industrial processing" is not defined in the Act, the Act specifies several things that are not to be considered industrial processing, and therefore are not tax exempt. These include tangible personal property permanently affixed to and becoming a structural part of the real estate, office supplies and equipment, food and beverages prepared for retail sale by a retailer, and services performed upon a property where the services do not transform, alter, or modify the property so as to place it in a different form or character.

Although the current provision exempting industrial processing was written in 1970, there has been an exemption since the 1940s. A similar exemption appears in the Sales Tax Act. The reason for allowing the exemptions, in part, is that if the end product is taxed, the components used or consumed in its production are not taxed so that the product is not subject to double taxation.

Recent developments in manufacturing have resulted in conflicting interpretations of the use tax exemption for industrial processing, particularly in cases in which manufacturers hire-out portions of a manufacturing job rather than do the job in-house. While many manufacturers have claimed an exemption of such activities, the Department of Treasury has denied those claims, saying that "outsourcing" is a service, rather than an integral part of the making or modifying of a product. The ever-expanding use of computers to run manufacturing operations or assist in product design has resulted in further confusion, as some consider computers a part of processing and others consider them to be performing a service, particularly in cases in which equipment engaged in manufacturing is run by computers that are located elsewhere, off the manufacturer's property. It has been suggested that the Act be amended to clarify what industrial processing is, and to exempt the use of computers under certain circumstances.

CONTENT

The bill would amend the Use Tax Act to exempt from the use tax, after December 31, 1984, computers used in operating industrial processing equipment; equipment used in a computer assisted design or engineering system integral to an industrial process; equipment used in a computer assisted manufacturing system; and, a subunit or electronic assembly comprising a component in a computer integrated industrial processing system.

Currently, the Act exempts from the use tax property sold to a person for use or consumption in industrial processing. The bill would exempt property sold to an "industrial processor" for use or consumption in industrial processing. The bill would define "industrial processor" as a person

who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor for further processing. Sales to a person performing a service, who did not act as an industrial processor while performing the service, would not be eligible for the use tax exemption.

Further, the bill would exempt from the use tax vehicles sold to regularly organized churches or houses of worship if the vehicle was a passenger van or bus with a manufacturers rated seating capacity of 10 or more, and if it was used primarily for transporting persons for religious purposes. (Note: This provision was placed in the Use Tax Act by Public Act 48 of 1986, but was subsequently inadvertently deleted by Public Act 52 of 1986 which also amended the Use Tax Act.)

MCL 205.94

FISCAL IMPACT

Senate Bill 323 (and companion House Bill 4696, which would place similar provisions in the Sales Tax Act) would result in an indeterminate reduction in GF/GP revenues of approximately \$400,000 per year. Last year, an estimated \$9 million in computer sales would have been exempt from State sales and use tax under the bills.

ARGUMENTS**Supporting Argument**

High-tech developments in manufacturing and "outsourcing" of manufacturing components have blurred the lines between what can definitively be considered industrial processing, and what cannot, regarding the granting of the industrial processing exemption from the use tax. This has resulted in a number of disputes, and cases brought before the Tax Tribunal, between the Department of Treasury and manufacturers, particularly in instances in which computers are used to design products or run machines that make products. At the center of the discussion is whether, in the various forms of computer-assisted production, those computers are performing a service or are actually processing products. In addition, according to the Department, some industrial processors have attempted to claim the industrial processing exemption for services such as trash hauling. The Department has taken the position that the exemption should be granted only for those things used to make or modify a product, and not for related services. The bill would make it clear what is to be considered a service and what is to be considered industrial processing, and end the dispute over the use of computers in manufacturing.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.

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