

# Legislative Analysis



## SALES AND USE TAXES: TELECOMMUNICATIONS EQUIPMENT EXEMPTION

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**House Bills 6277 and 6278**  
**Sponsor: Rep. Fulton Sheen**  
**Committee: Tax Policy**

**Complete to 9-11-06**

### **A SUMMARY OF HOUSE BILLS 6277 AND 6278 AS INTRODUCED 6-28-06**

The General Sales Tax Act (MCL 205.54v) and Use Tax Act (205.94q) generally exempt from taxation the purchase of machinery and equipment used in providing taxable communication services (see Background Information below) if the machinery and equipment:

1. Is located on the premises of the subscriber, or
2. Is central office equipment or wireless equipment directly used or consumed in transmitting, receiving, or switching two-way interactive communication.

The acts further provide that beginning April 1, 1999, there is an irrebuttable presumption that 90 percent of the use of the machinery and equipment is for exempt purposes. The presumption was to remain in effect until April 1, 2006, at which time the Department of Treasury was required to review and re-determine the presumption using exempt and non-exempt user information for the previous year. The department must review the presumption and make a re-determination every seven years.

House Bills 6277 and 6278 would delete the requirement that the department review the presumption, and instead provide that beginning April 1, 2006 there is a rebuttable presumption that 100 percent of the total use of the machinery and equipment is for exempt purposes.

### **FISCAL IMPACT:**

Together, the bills would reduce sales and use tax revenue by an estimated \$2.0 million. The majority of this amount would come from the School Aid Fund, which receives 33.3 percent of use tax revenue and about 73.3 percent of sales tax revenue.

### **BACKGROUND INFORMATION:**

The Use Tax Act (MCL 205.93a) provides that intrastate telephone, telegraph, leased wire, and other similar communications, including local telephone exchange and long distance telephone service that both originates and terminates in Michigan – except telephone service by coin-operated installations, switchboards, interoffice circuitry and their accessories – are taxable under the act. The act also provides that interstate

telephone communications that either originate or terminate in the state and is billed to a Michigan address or phone number, except 800 prefix service and international calls, are also subject to the tax. Generally speaking, the act (MCL 205.93b) also subjects mobile telecommunication service to taxation.

Rule 60 of the General and Specific Sales and Use Tax Rules (R. 205.110) further notes that the use tax does not apply on sales of services to the U.S. government, the state and its political subdivisions, the American Red Cross, schools, hospitals, homes for the aged, or other nonprofit charitable institutions. The rule further states, "sales or use tax applies on purchases of tangible personal property by sellers of taxable communications services except exemption will prevail on the necessary exchange equipment and on the tangible personal property acquired for installation on the premises of the subscriber. Sales or use tax will apply on tangible personal property purchased and used in providing the exempt services."

The exemption for telecommunications equipment has been in place since the enactment of Public Acts 219 and 220 of 1962. The irrebuttable presumption provisions were added with Public Acts 116 and 117 of 1999 in response to the Court of Appeals decision in *Michigan Bell Telephone Company v. Department of Treasury*, 229 Mich App 220 (1998). At issue in this case, was whether, among other things, the Department of Treasury could apportion the exemption based on whether the underlying phone service was taxable (e.g. if the equipment is used for a taxable service 85 percent of the time and 15 percent of the time for a non-taxable service, the exemption must be reduced by 15 percent). The court upheld the decision of the Michigan Tax Tribunal (Docket No. 220870), which held that the department could not apportion the exemption, stating, "where taxable personal property is used from the very outset and constantly used thereafter for exempt purposes and if the exempt use is substantial, that property is entitled to a full exemption. Conversely, if the property is not used from the very outset and constantly thereafter for exempt purposes or if the exempt use is not substantial, the exemption should be apportioned."

The exemption for communication equipment is similar in concept to the industrial processing exemption in the sales and use tax acts. Generally speaking, the acts do not apply to property that is used in industrial processing (i.e. changing the form of tangible personal property for retail sale or use in manufacturing a product to be sold at retail), and the exemption is apportioned based on the percentage of exempt use to total use. [See the General Sales Tax Act at MCL 205.54t and the Use Tax Act at MCL 205.94o.]

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