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STATE AND LOCAL TAX NEWSLETTER

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State Tax Commission to Address Property Tax Classification Issue

GRAND RAPIDS, MI – Monday, September 8, 2008 - On 8/19/08, the Michigan State Tax Commission voted to seek comment on proposed principles for classification of personal property. The State Tax Commission is trusted with the responsibility to oversee the administration of the Michigan property tax system. Since the adoption of the Single Business Tax personal property tax credit and the Michigan Business Tax personal property tax credit and personal property tax millage exemptions for some personal property, many assessors have questioned their previous determinations of classification. Qualification for the tax credits or millage exemptions are based on the classification of the personal property.

The proposal stated: “many assessors have questioned their previous determinations of classification. In many cases, these previous determinations have been modified or challenged, despite the fact that they were probably correct.”

The proposal also states: “we believe that in interpreting MCL 211.34c, the focus should be the original goal of property classification, which was to provide a technical tool to assure uniformity of assessments from one type of property use to the next.”

The staff of the State Tax Commission has released a series of sixteen guiding principles which they believe should be considered when deciding the classification of personal property. The sixteen principles to guide the classification process cover almost eleven complete pages with their reasoning.

The complete text of the proposal can be found on the State Tax Commission website at:

http://michigan.gov/documents/treasury/ClassMemo221_246017_7

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Comments should be sent to: StateTaxCommission@michigan.gov by October 1, 2008.

Following are the proposed guiding principles. The reasoning behind the principles can be found in the State Tax Commission staff memo referenced above.

FIRST PRINCIPLE: All personal property subject to ad valorem assessment which is owned by the same taxpayer at a given location should be similarly classified, according to the usage which most significantly influences the total valuation of the personal property at that location, even if multiple personal property parcels have been established and multiple parcel identification numbers assigned to that location. For purposes of implementing this Principle, "location" is deemed to include all real property parcels that are contiguous and are not separated by a public right of way and "taxpayer" is deemed to include all entities that are affiliates or that would be considered to be members of the same control group for the purposes of MCL 211.27a(7)(j) and MCL 211.27a(7)(l).

SECOND PRINCIPLE: The classification of personal property under MCL 211.34c is not dependant on, or controlled by, the MCL 211.34c classification of the real estate on which it rests on Tax Day. Instead, the classification of personal property at a location which is owned by the same taxpayer is determined by the usage of said personal property which most significantly influences the total valuation of the personal property of that taxpayer at that location.

Reasoning:

THIRD PRINCIPLE: To be industrial personal property, the property must be directly used to carry on an industrial activity. For purposes of MCL 211.34c, industrial activity is the:

- Manufacturing of parts, components and subassemblies used to make finished goods; or,
- Manufacturing of finished goods, including the assembly of finished goods and the processing of food, when the activity produces goods for sale to those engaged in wholesale or retail trade; or,
- Conduct of research and development activity, but only when the research and development activity is carried out by the

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taxpayer for the purpose of developing improvements to existing designs, or developing new designs of parts, components, subassemblies, or other products of a tangible personal property nature, which will be manufactured by that taxpayer, or its affiliates; or

- Extraction of raw materials and minerals from the ground; or
- Processing or refinement of substances to be used as raw materials in later industrial or commercial processes or for sale to those engaged in wholesale or retail trade of such substances; or,
- Generation of electricity for the taxpayer's own use in engaging in industrial activity or for sale to the public or to public utilities.

Activity which otherwise meets the definition of industrial activity, as described above, is not disqualified from such treatment by the fact that the taxpayer markets the parts, components, subassemblies, finished goods, or other products of a tangible personal property nature itself, or builds machinery or equipment used for business purposes to the business customer's specifications. Generally, however, the construction of real property structures, the construction of public improvements, and the construction of land improvements, or the providing of construction materials for such activities, is a commercial activity, not an industrial activity. Further, the making of consumer goods to the end-user's specific order and/or specification is not an industrial activity, unless the specification can be deemed merely the selection of one of several standard pre-established options of a consumer product.

FOURTH PRINCIPLE: To be commercial personal property, the property must be used to carry on a business activity which does not result in it being classified as agricultural or utility personal property and which does not meet the definition of industrial personal property contained in the THIRD PRINCIPLE above.

FIFTH PRINCIPLE: Activities which:

- Entail the breakdown of larger shipments or lots into customer orders; or
- Constitute wholesale or retail trade; or
- Entail the measurement, cutting, fitting, mixing, combination or

assembly of ingredients, materials or other commodities that are manufactured or extracted elsewhere, to the specific order and/or specifications or needs of an end-user, for immediate delivery to that end-user, either for installation on the premises of the end-user, or for the immediate use or placement into use or service by that end-user; or

- Entail the production of a artistic or graphic design applied to a commercial product or as a artistic limited edition or unique item; or
- Entail research and development, engineering or testing that is performed by an independent contractor, or as speculative research that is not associated with product development by a manufacturer; or
- Entail the repair or rebuilding of existing personal property, even if significant replacement parts are installed; or
- Entail the construction of real property structures, the construction of other improvements to real property or the construction of public or private infrastructure; are not industrial activities, even if a mixing or assembly process results in the occurrence of a chemical reaction. Instead, such an activity is the delivery of a service, which, in turn, is a commercial activity.

SIXTH PRINCIPLE: Personal property of a taxpayer at a given location which is not used for industrial, agricultural or utility purposes as defined by MCL 211.34c is commercial personal property, even if the personal property is owned by an industrial taxpayer, and even if the activity in which the personal property is used is carried out as part of a larger industrial activity conducted at the same or another location.

SEVENTH PRINCIPLE: The rental or leasing of real property is a commercial activity and landlord-owned personal property that is located on premises which are rented or leased is classified as commercial personal property, regardless of the classification of the real property and regardless of the activity of tenant.

EIGHTH PRINCIPLE: Rental and leasing of personal property is a commercial activity, regardless of the use to which the personal property is being put by the renter or lessee.

NINTH PRINCIPLE: In cases where it may be unclear whether the

owner of the personal property is engaged in an industrial activity, the determination shall be based on whether, as its principle business undertaking at that location, the owner intends to be exposed to the possibility of greater or lesser profit, or the possibility of loss, that arises directly from the success, or lack of success, of an industrial activity. For example, a personal property owner, such as an equipment lessor, who does not directly share in the fruits of success or directly bear the risk of failure of an industrial endeavor, is not engaged in manufacturing. On the other hand, if the owner of the personal property places machinery and/or equipment at the industrial plant of a contractor, for use by that contractor in manufacturing goods on behalf of the owner, then the owner is deemed to be engaged in manufacturing even if it does no actual manufacturing at that location.

TENTH PRINCIPLE: Unless one or more items of personal property used is being leased, all property, including any associated easement or right of way interests, that is physically integrated into, and necessary for the proper functioning of an electric transmission or distribution system, a gas distribution pipeline system or a gas or fluid hydrocarbon transmission pipeline system, is classified as utility personal property, even if the personal property is physically located on real property owned by the utility.

ELEVENTH PRINCIPLE: The eligibility of personal property which is covered by an Industrial Facilities Exemption Certificate (IFT) for exemption from up to 24 mills of local school operating millage (and for a credit against Michigan Business Tax liability) is determined by the classification of the land on which the personal property is located. If the land is classified as Industrial Real Property, then the IFT personal property located on that land qualifies for the partial exemption of up to 24 mills. This PRINCIPLE does not apply to personal property on the ad valorem assessment roll.

TWELVTH PRINCIPLE: Attached building components installed by the owner of the building that become fixtures are assessed and classified as real property, not as personal property, regardless of the method used to record the components on the owner's financial accounting records and regardless of the method of reporting used for Federal income tax purposes, unless established assessment practice clearly provides otherwise.

THIRTEENTH PRINCIPLE: Trade fixtures, which are not real property fixtures, as described in the TWELTH PRINCIPLE above, are assessed to the tenant as personal property and are classified

in conjunction with the tenant's other personal property. The classification of both the trade fixtures and the rest of the personal property owned by a taxpayer at given location is determined by the usage of said personal property which most significantly influences the total valuation of the personal property of that taxpayer at that location.

FOURTEENTH PRINCIPLE: The State Tax Commission recommends that tenant-installed leasehold improvements should be assessed as part of the landlord-owned structure in which they are integrated, whenever it is practical to do so, and should be classified as part of the landlord's real property assessment classification. If it is impractical, or in the rare instances where it is illegal, to assess the leasehold improvements as part of the landlord's real property, such leasehold improvements may be assessed as personal property and classified in conjunction with the tenant's other personal property, determined by the usage of said personal property which most significantly influences the total valuation of the personal property of that taxpayer at that location.

FIFTEENTH PRINCIPLE: Commercial wind energy systems, including associated easement and right of way interests, are classified as industrial personal property. The land on which the system is located is not generally classified as industrial real property and, instead, is classified according to the use which most significantly influences the total valuation of that real property parcel.

SIXTEENTH PRINCIPLE: When interpreting MCL 211.34c(5), the phrase "classification that most significantly influences the total valuation of the parcel" shall mean that if some personal property of the taxpayer at the location is used for commercial activity and other personal property of the taxpayer at the location is used for industrial activity, then the assessor shall classify the personal property based on the relative true cash values of the personal property engaged in each activity. If the same item of personal property is used to engage in both commercial and industrial activities, then the activity that provides the largest net revenue shall be the activity that determines the classification treatment of that item.

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available. If you have any questions, please go ahead and contact me. I will be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA



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