

USE TAX BASE: MANUFACTURERS OF MODULAR BUILDING UNITS AND MANUFACTURED HOMES

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House Bill 5873

Sponsor: Rep. Bruce Caswell

Committee: Tax Policy

Complete to 5-16-06

A SUMMARY OF HOUSE BILL 5873 AS INTRODUCED 3-15-06

House Bill 5873 would allow a manufacturer of premanufactured modular building units (e.g. modular homes) or manufactured homes that does not maintain an inventory of products made available for sale to others to pay use tax based on the sum of (1) the cost of materials and (2) the labor costs, except for the costs of actually affixing the property to the real estate. Currently, these manufacturers must use a method that bases the tax on "finished goods inventory value."

Generally speaking, the Use Tax Act provides that *property affixed to real estate by the manufacturer* is subject to taxation under the act. The tax base is either the material and direct labor costs or the finished goods inventory value, depending on whether or not the manufacturer maintains an inventory or makes its product available to others by publication or price list.

- For a manufacturer who affixes its product to real estate *and maintains an inventory of its product that is available for sale to others by publication or price list*, the use tax is based on the direct and indirect production costs (often described as the "finished goods inventory value") of the product that are incident to and necessary for production or manufacturing operations or processes, as defined by the Department of Treasury.
- For a manufacturer who affixes its product to real estate *but does not maintain an inventory of its product available for sale to others or make its product available for sale to others by publication or price list*, the use tax is based on the sum of (1) the cost of the materials and (2) the labor costs, except for the costs of actually affixing the property to the real estate.

As noted above, the bill would allow a manufacturer of premanufactured modular building units (e.g. modular homes) or manufactured homes that does not maintain an inventory of products made available for sale to others to use the second tax base described above (cost of materials and labor) rather than the first tax base ("finished goods inventory"). The bill would delete any reference for such manufacturers to "publication and price list."

In addition, the bill adds that if the manufacturer of a premanufactured modular building unit or manufactured home sells the unit or home to another for permanent affixation to real estate, the manufacturer is not required to perform the affixation of the unit or home to the real estate if the unit or home is permanently affixed to the real estate by the purchaser.

The bill defines "premanufactured modular building unit" to mean a building designed and constructed pursuant to the Stille-DeRossett-Hale Single State Construction Code Act that is manufactured in one or more sections in a factory for installation on a permanent foundation at its final location. It does not include a mobile home or a manufactured home constructed on a permanent chassis in compliance with the federal National Manufactured Housing Construction and Safety Standards Act of 1974 (i.e., the "HUD Code").

The bill defines "manufactured home" to mean means a structure, transportable in 1 or more sections, which, in the traveling mode, is 8 body feet or more in width or 40 body feet or more in length, or when erected on site, is 320 or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems. The term includes any structure that meets all of the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the secretary of the Department of Housing and Urban Development and complies with the standards established under title 42 of the United States Code. [The bill imports the definition of "manufactured home" from the Uniform Commercial Code, MCL 440.9102.]

FISCAL IMPACT:

According to the Department of Treasury, the bill would reduce Use Tax revenue by an estimated \$2.0 million to \$3.4 million on an annual basis. This is two-thirds General Fund/General Purpose revenue and one-third School Aid Fund revenue.

BACKGROUND INFORMATION:

Tax Treatment of Modular and Manufactured Homes

The sales or use tax on manufactured and modular homes affixed to the real estate of others may be calculated in a number of ways. If an in-state manufacturer sells a home at retail to a dealer/contractor and has no further obligation to affix the property to real estate, the sale is subject to sales tax on the full selling price of the home.¹

¹ The Use Tax Act defines "consumer" to mean a person who has purchased tangible personal property or services for storage, use, or other consumption in the state and includes a person acquiring tangible personal property if engaged in the business of constructing, altering, repairing, or improving real estate of others. In a sales transaction between a modular home manufacturer and the dealer, where the dealer, rather than the manufacturer, has an obligation to affix the property, the dealer is considered to be the "consumer" subject to taxation, because it is

If an out-state manufacturer sells a home to a dealer/contractor and has no further obligation to affix the property to real estate, the sale is either subject to Michigan sales tax (if the transaction occurs here) or the sales/use tax of the manufacturer's home state (if the sale occurs there). [Note: Most modular home manufacturers selling homes in Michigan are located outside of Michigan, with many located in Indiana.] In this instance, the dealer/contractor affixing the property would be liable for the use tax, also based on the full selling price, although tax liability would be offset by the amount of taxes paid in the state where the transaction occurred.

When the manufacturer affixes the property to real estate, it is subject to the use tax based on either the material and direct labor costs or the finished goods inventory value, depending on whether or not the manufacturer maintains an inventory or publication or price list, as described above. Reportedly, in nearly all cases, the manufacturer, whether through its own employees or through a contractor, will have the obligation to affix the home to real estate. In this situation, both the contractor and the manufacturer are potentially liable for use tax. However, the Department of Treasury often looks to the manufacturer first because the manufacturer would know the home's finished goods inventory value or the cost of labor and materials used in constructing the home.

Industry officials note that modular homes are custom-built, just like traditional stick-built homes, and manufacturers do not maintain an inventory of homes from a sales lot.² They contend, however, that the current reading of the statute nevertheless subjects them to a higher use tax liability based on the finished goods inventory value because of their use of sales brochures—typically showing photographs of various styles and sizes of homes.

Legislative History

The provision in the Use Tax Act that the bill addresses was added with the enactment of Public Act 172 of 2004, part of the Streamlined Sales and Use Tax Agreement legislation. The act essentially recodified—although not verbatim—the act's definition of "price" (MCL 205.92), as amended by Public Act 506 of 1988, as further defined in Revenue Administrative Bulletin 1993-5 and Rule 21 (R 205.71) of the General and Specific Sales and Use Tax Rules concerning contractors.³

Prior to the enactment of Public Act 172 of 2004, the Use Tax Act's definition of "price" stated:

engaged in the business of improving real estate. The subsequent sale from the dealer to an individual wouldn't specifically be subject to taxation, although the amount of taxes paid by the dealer would likely be included in the purchase price.

² Both modular and stick-built homes are subject to the same residential building code. Manufactured homes, by contrast, must meet the federal HUD Code.

³ Even though the statutory provisions on which RAB 1993-5 have been amended since the bulletin was first issued, the bulletin remains in effect. It appears, then, that amendments to the Use Tax Act made by Public Act 172 of 2004 are merely technical in nature.

- The price of tangible personal property, for affixation to real estate, withdrawn by a construction contractor from inventory available for sale to others or made available by publication or price list as a finished product for sale to others is the finished goods inventory value of the property.
- If a construction contractor manufacturers, fabricates, or assembles, tangible personal property before affixing it to real estate, the price of the property is equal to the sum of materials cost of the property and the cost of labor to manufacture, fabricate, or assemble the property but does not include the cost of labor to cut, bend, or assemble the property at the site for affixation to real estate. For property withdrawn by a construction contractor from inventory available for sale to others, the materials cost of the property means the finished goods inventory value of the property.

Revenue Administrative Bulletin 1993-5

RAB 1993-5 was issued to explain the use tax liability of contractors who manufacture, fabricate, or assemble tangible personal property before affixing it to real estate. It provides that the use tax base for a manufacturer/contractor is as follows:

- For a manufacturer who affixes its product to real estate and maintains an inventory of its product for sale to others ***or makes its product available to others through publication or price list***, the use tax is based on the "finished goods inventory value" of the product. [The bulletin also notes that this type of manufacturer would be entitled to an industrial processing exemption from sales and use tax on property used or consumed in manufacturing the property.]
- For a manufacturer who affixes its product to real estate, but does not maintain an inventory of its product ***or does not make its product available for sale through publication or price list***, the use tax is based on the sum of (1) the cost of the materials and (2) the labor costs, except for the costs of actually affixing the property to the real estate. [The bulletin notes that this type of manufacturer would not be entitled to an industrial processing exemption.]

Finished Goods Inventory Value

The bulletin's definition of "finished goods inventory value" follows U.S. Department of Treasury regulations (26 CFR 1.471-11) on the inventories of manufacturers. Generally, the finished goods inventory value includes direct material and labor costs and indirect production costs. Direct material costs include, but aren't limited to, raw material, supplies entering into the product, and supplies consumed in connection with the product. Direct labor costs include, but aren't limited to, basic wages, overtime wages, vacation and holiday pay, sick leave pay, payroll taxes, payments to a supplemental unemployment benefit plan, and any other payment incurred on behalf of employees directly engaged in production. Indirect production costs include maintenance expenses, repair costs, utility costs, rent and taxes on building and machinery necessary for

production, indirect labor and production supervisory wages, and other miscellaneous indirect costs, such as depreciation, officer's salaries, insurance costs, and quality control and inspection costs.

Publication and Price List

The bulletin defines "publication" to mean printed material the purpose of which is to offer tangible personal property for sale to others. Printed material includes, but is not limited to, a catalog, sales pamphlet, or sales handbill.

The bulletin defines "price list" to mean a numerical or alphabetical enumeration of goods, wares, or merchandise items, quoting whole and/or retail prices and printed on cards or sheets of paper, presented in loose-leaf form, stapled, stitched, or bound, or available on computer database, disk, or tape, the purpose of which is to offer tangible personal property for sale to others.

Rule 21 of the General and Specific Sales and Use Tax Rules

Rule 21 (R 205.71) provides that contractors are consumers of materials used by them. All sales to or purchased by contractors of tangible personal property are taxable, except when affixed to and made a structural part of a qualified exempt organization (e.g. nonprofit hospital). The rule further provides that where a manufacturer affixes its product to the real estate of others, that manufacturer is considered a contractor and shall remit use tax on the purchase on the inventory value of the property at the time the property is converted to the contract, with the value including all manufacturing, fabricating, and processing costs.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.