

INTERNAL POLICY DIRECTIVE 2005-3

December 7, 2005

SALES AND USE TAXES

REAL PROPERTY CONTRACTORS ACTING AS RETAILERS

POLICY ISSUE

How will the Department treat the sales and use tax obligations of real property contractors who consistently hold themselves out to their customers as retailers by itemizing materials on their billings and charging sales tax on those materials?

POLICY DETERMINATION

As a general guideline, real property contractors that consistently hold themselves out to the public as retailers, and who consistently collect and remit sales tax in a manner consistent with the General Sales Tax Act (1933 PA 167, as amended) are liable for sales tax on the appropriate "sales price" measurement of those sales as though the contractor were making "sales at retail" within the meaning of the General Sales Tax Act.

DISCUSSION

The Department of Treasury has long recognized the policy expressed in the above guideline as reflecting a practical administrative response to industry practices and customer expectations. The policy was formally expressed in a public document directed at a specific industry in Revenue Administrative Bulletin (RAB) 1988-35 titled "Carpeting".

A real property contractor is statutorily considered a consumer of the materials used in the activities of constructing, altering, repairing, or improving real estate for others. Its sales and use tax obligation is generally (except for manufacturer/contractors) 6% of the cost of materials used in the job.

This policy of allowing contractors who consistently hold themselves out as retailers to treat themselves as retailers who are making sales at retail is grounded in the fact that the State of Michigan will receive at least as much sales tax revenue from the contractor as it would receive should the contractor pay sales or use tax on its purchases. **IT IS IMPORTANT TO NOTE THAT WHERE THIS IS NOT THE CASE THE ADMINISTRATIVE POLICY WILL NOT BE FOLLOWED.**

The policy is also grounded in a recognition that some contractors are not sophisticated in sales and use tax matters and engage in the business practice of billing sales tax to their customers with a belief that that is a correct treatment of the transaction. It is also noted that in many instances the customer expects to be charged sales tax. An example of a transaction of this type might be when a heating and cooling contractor comes to a residence and repairs an existing furnace by installing a new blower motor. A common contractor business practice is to bill the blower motor at a retail price, add sales tax (6% of the blower motor itemized sales price), and separately itemize labor without tax.

Application of the policy should not be limited to repair and maintenance activities. It will also apply to new installations or other relatively major transactions. For example, should a heating and cooling contractor consistently treat all its transactions as sales tax transactions, the Department will not attempt to distinguish a new installation from a repair and tax them differently.

The Department will also recognize reasonable distinctions in business activities. For example, should the heating and cooling contractor distinguish new furnace installations from repair transactions and treat the repair consistently as sales tax transactions and, at the same time, consistently treat the new installations as non-sales tax transactions, the Department will accept that treatment.

When allowing sales tax treatment to a contractor who consistently applies sales tax, the Department will recognize a complete sales tax treatment including sales tax exemptions. For example, a contract to repair a furnace in a building owned by the United States government would not normally qualify as an exempt real property contract, and the contractor would be required to pay sales or use tax on the cost of materials used. However, if the contractor consistently applies sales tax treatment to its transactions, the Department will generally allow the transaction to be treated as tax exempt, as though it were an actual sales tax transaction.

There are exceptions to this general policy practice of recognizing sales tax exemptions. Recall that the policy is fundamentally grounded in the fact that the State of Michigan will receive at least as much tax as would otherwise be due. This fact negates the Revenue Act, 1941 PA 122 as amended, prohibition against compromise of tax. Tax is not compromised because the State of Michigan receives full benefit of the tax. However where this is not true the Department cannot allow sales tax treatment.

The Department will look to an aggregation of transactions to determine if adequate tax has been remitted. If the Department looks at all transactions for a period and finds that the sales tax remitted is less than the sales or use tax that should have been remitted on cost of materials, the Department must assess additional tax. The additional tax amount to be assessed will be the net amount of: 6% tax calculated on cost of materials less sales and use tax the contractor has paid directly to the department. This type of underpayment situation will generally only occur when a significant number of transactions exist that could qualify for sales tax exemption that would not be exempt for a real property contractor.

A significant number of exempt sales tax transactions may occur if a disproportionate amount of real property contractor transactions are with entities such as the United States government. It also may occur if a disproportionate amount of real property contractor transactions represent out-of-state jobs where an interstate commerce sales tax exemption is claimed when purchasing or when withdrawing material from inventory. It may also occur for a contractor whose only business activity is to provide and install materials in United States government buildings. Materials installed in United States government buildings would represent a taxable contract, and sales of those materials without installation to the United States government would represent an exempt sales tax transaction. The Department would not allow the contractor whose only activity is real property installation for sales tax exempt entities to choose sales tax treatment because the State of Michigan would receive less sales tax than the amount of sales and use tax due under treatment as a real property contractor.

The Department's policy is based on, and justified by, a belief that both the administration of sales and use taxes and the general business environment for real property contractors are enhanced without a reduction of tax revenues. However, "no tax" is not an option, and less sales tax paid than the contractor would otherwise owe on cost of materials is also not allowable.