

April 2007***Michigan Court of Appeals Limits Michigan Use Tax to Raw Materials Cost of Manufacturer Lessor***

In 1995, we commenced litigation against the Michigan Department of Treasury on behalf of WMS Gaming, Inc., a Waukegan, Illinois based manufacturer of casino gaming equipment. WMS purchased the component parts for the gaming equipment and manufactured the equipment outside Michigan. Once completed, some of the gaming equipment was shipped into Michigan where it was leased to various casinos. The Michigan Department of Treasury conducted a field audit and asserted Michigan use tax was due upon the stream of rental payments received by WMS pursuant to the equipment leases. WMS contended that its use tax liability was limited to the cost of the raw materials from which it manufactured the equipment.

Michigan use tax provides (MCL 205.92(f)) that the "price" upon which use tax is calculated is the aggregate value in money of anything paid or delivered by a consumer to a seller in consummation of a transaction by which tangible personal property is purchased or rented for storage, use or consumption in the state. The tax imposed may not be computed on rental receipts if the tangible personal property rented or leased has previously been subjected to a Michigan sales or use tax when purchased by the lessor. WMS took the position that it had an acknowledged use tax liability when the gaming machines came into Michigan, based upon the price of the machines, that is, the aggregate value of the machines based upon the purchase price of the component parts. Since use tax was based upon the purchase price of the machines, there is no use tax imposed on the rental receipts because the property that has been leased has previously been "subject to" the Michigan use tax.

Notwithstanding, the Department advanced its Revenue Administrative Bulletin 1988-39 that attempted to establish three distinct categories of lessors. The first, a lessor-consumer, pays sales tax on the purchase of property which is then leased. A lessor consumer does not pay use tax on its rental receipts. The second, a lessor-retailer, does not pay sales tax on the purchase price of the property but instead elects to pay use tax on its rental receipts. The third disputed category, and the one which Treasury attempted to apply to WMS, is a manufacturer who leases property that it has manufactured itself. Treasury contends in its bulletin that such

a manufacturer cannot be a lessor-consumer eligible to pay use tax on the price of the property it has purchased but must collect use tax on rental receipts.

The Michigan Court of Appeals rejected the artificial tax construct contained in Treasury's Bulletin. The Court held that a manufacturer, without regard to whether the product is manufactured in-state or out-of-state, may elect to pay a sales or use tax on the purchase price of the components of the product or pay a use tax on the rental receipts from leasing the product.

The WMS case represents the third time in the last five years that the Michigan courts have refused to give credence to a Treasury Bulletin found to be inconsistent with or unsupported by the underlying statute imposing the tax. *Danse Corp v City of Madison Heights*, 466 Mich 175; 644 NW2d 721 (2002); *Catalina Marketing Sales Corporation v Michigan Dep't of Treasury*, 470 Mich 13, 678 NW2d 619 (2004, Use Tax).

The WMS case illustrates the importance of remaining objective, and discerning, when considering the applicability of a Revenue Administrative Bulletin to a particular transaction. In determining the taxable nature of a transaction, these bulletins are only a starting point in the analysis, as most recently demonstrated by the Court of Appeals' decision in WMS, and are frequently disregarded when not supported by the underlying statute which they presume to interpret.

Property Tax Update

Michigan House Bill 4375, which would create a new tax for commercial and industrial rental property, passed out of the House Tax Policy Committee on March 28. The Committee also passed House Bill 4376 which exempts from the General Property Tax Act property that is subject to the new tax. The intent of the bills is to enable the government to increase taxable values where previously there had been taxable value reductions due to vacancies and the property has become occupied subsequent to the vacancy reductions. Since the Honigman firm obtained a favorable Michigan Supreme Court decision in May of 2002, such occupancy addition taxable value increases have been prohibited.

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