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## MBT Draft Proposed Rule – Materials and Supplies

### R 208.8 Materials and supplies

Rule 8. “Materials and supplies” as used in section 113(6)(c) of the Act means tangible property, including repair parts and fuel, which meet all of the following:

- (a) Are not inventory or depreciable property as defined in these rules or sections 113(6)(a) and (b) of the act; and
- (b) Are acquired by the taxpayer during the tax year; and
- (c) One of the following:
  - (i) The tangible property is used or consumed in and directly connected to the production or management of taxpayer’s inventory; or
  - (ii) The tangible property is used or consumed in and directly connected to the operation or maintenance of taxpayer’s depreciable property; or
  - (iii) The tangible property is necessary in order for taxpayer’s depreciable property to perform their intended function or purpose.

### R 208.9 Requirements of ownership of inventory and depreciable property

Rule 9. The taxpayer must have either title to or other indicia of ownership over the inventory or depreciable property for which the materials and supplies acquired during the tax year are to be used or consumed, or, in the case of depreciable property are able to depreciate or amortize such property on the taxpayer’s books for federal income tax purposes.

### Rule 208.10 Definitions

Rule 10. As used in these rules:

- (a) “Depreciable property” means tangible property of a type that is, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.
- (b) “Directly connected to” means that the application or nexus between the use or consumption of the tangible property and the affected inventory or depreciable property is direct and not subject to any intermediary or indirect application to inventory or depreciable property.
- (c) “Fuel” means materials used and consumed to produce heat or power by burning. Fuel does not include electricity.
- (d) “Inventory” means the following:
  - (i) The stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale.
  - (ii) Finished goods, goods in process, and raw materials of a manufacturing business purchased from another person.

## R 208.11 Examples

Example 1: A retailer purchases Universal Product Code (UPC) bar code labels, which it uses for long-distance scanning in its warehouses and rack marking for aisles, racks, shelves and bins in order to track the location and flow of the retailer's inventory. The bar code labels the retailer purchased are materials and supplies under MCL 208.1113(6)(c) since they are used for and directly connected to managing the location, status and flow of the retailer's inventory.

Example 2: A trucking company contracts with a manufacturer of consumer products to distribute the manufacturer's products to wholesalers throughout the country. The trucking company transports the products using a fleet of trucks, some of which it owns and some of which it leases pursuant to standard lease arrangements with other trucking companies. The trucking company capitalizes on its books the cost of the trucks it owns and takes a depreciation deduction on such trucks when computing its federal taxable income. The trucking company does not capitalize or depreciate the trucks it leases on its books. The trucking company purchases diesel fuel for both its owned trucks and its leased trucks. The diesel fuel purchased for its owned trucks would qualify as materials and supplies under MCL 208.1113(6)(c) since the diesel fuel is necessary to operate the trucks which are taxpayer's depreciable property. The diesel fuel purchased to operate its leased trucks, however, would not be materials and supplies under MCL 208.1113(6)(c) since the trucks are not eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes on the books of the trucking company, as required under Rule 9.

Example 3: Taxpayer is an "urgent care clinic" that provides medical care to walk-in patients who require diagnosis and treatment on an urgent, but not on an emergency basis. The patients visiting the clinic might suffer from a variety of maladies, including broken bones, skin abrasions, skin rashes, head concussions, influenza, minor bleeding, etc. The taxpayer purchases various supplies, such as cast making materials (e.g. bandages, plaster of Paris), splints, medicated creams, various pharmaceuticals, antibiotics, and other supplies that may be provided to patients in the clinic's provision of medical services. The clinic does not hold these items in stock for resale as such to its patients, rather such items are supplies that may be used by the clinic or provided to patients incidental to or in conjunction with the clinic's provision of medical care services. Consequently, the items are not considered inventory under MCL 208.1111(4)(a) or Rule 10(d). Furthermore, while these items are used by the clinic or provided to the clinic's patients in the provision of medical services, the items are not considered materials and supplies under MCL 208.1113(6)(c) because the clinic does not use or consume the items in order to maintain or produce any inventory or to operate or maintain depreciable property as required under Rule 8(c).

Example 4: Taxpayer is a dental practice that owns an X-ray machine used to take X-ray scans of patients' teeth. The X-ray machine is capitalized on the taxpayer's books and the taxpayer takes depreciation deductions when calculating its federal taxable income. The X-ray machine does not take digital pictures, but rather requires the use of X-ray film, which the dental practice develops in-house. The film is loaded into the X-ray machine and the X-ray machine projects the X-ray picture onto the loaded film. The X-ray film purchased by the taxpayer is considered materials and supplies under MCL 208.1113(6)(c) since, under Rule 8(c)(iii), the X-ray machine could not perform its intended function, producing an X-ray of a patient's teeth, without loading the film into the X-ray machine.

Example 5: Taxpayer is an industrial smoothing company that smoothes and polishes various metals and alloys to very precise specifications with very small imperfection tolerances. The metals and alloys are then used by its customers in the manufacturer of various types of high-precision equipment and machinery. The smoothing equipment the company uses in its smoothing operations functions by propelling micro ball bearings and sand particles at very high velocities and pressures against the surfaces of the metals or alloys. The company purchases substantial quantities of micro ball bearings and sand for use in the smoothing equipment. The micro ball bearings and sand would be considered materials and supplies under MCL 208.1113(6)(c) since, under Rule 8(c)(iii), such materials are required in order for the smoothing equipment to perform its intended function.

Example 6: The taxpayer is a wholesale food distribution company that operates a large warehouse within which it stores its inventory and from which it delivers such inventory to its retailer customers. The taxpayer leases a fleet of forklifts from a heavy machinery company through various standard lease agreements. The taxpayer uses the forklifts to maintain its inventory stock by lifting and shuttling pallets and boxes to and from storage locations and to and from truck bays. Under the standard lease agreements, the taxpayer is responsible for maintenance of the forklifts and for purchasing repair parts for the vehicles. The repair parts purchased by the taxpayer are not considered materials and supplies under MCL 208.1113(6)(c). Although the repair parts are used to maintain and operate the taxpayer's fleet of forklifts, the taxpayer uses the forklifts subject to standard lease agreements. Consequently, the taxpayer neither owns the forklifts nor is able to depreciate or amortize such property on its books for federal income tax purposes, as required under Rule 9. While the forklifts themselves are used to maintain taxpayer's inventory and the repair parts purchased are used and directly connected to the operation and maintenance of the forklifts, the repair parts purchased for the forklifts are not directly but rather indirectly connected to the maintenance of the inventory. There is no direct nexus between the repair parts purchased and the maintenance of inventory, as required under Rules 8(c) and 10(b).