

# Michigan Tax Considerations for Alternative Energy Producers

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Alternative energy producers planning to locate or expand in Michigan face a number of unique tax challenges. As a dynamic and highly technical industrial sector that has experienced tremendous growth over the last decade, the alternative energy industry raises tax questions that are novel and nuanced. Most Michigan tax statutes were written in the context of traditional energy production activity, and subsequent legislative developments have often failed to keep pace with technology and the economic realities of alternative energy production. These factors present alternative energy producers with both uncertainty and opportunity; the questions they raise today do not always have clear answers, but the surrounding discussion and debate will likely prove critical in shaping Michigan's future tax environment.

Under these conditions, a clear understanding of current Michigan tax law and a capacity for creative problem solving will be key to successful tax planning for an alternative energy producer. This article is intended to provide a brief overview of some of the significant taxes imposed in Michigan, along with the complexities that may arise as these taxes are applied to the alternative energy industry.

## I. Property Tax

Michigan property taxes are imposed and collected by cities or townships. The taxes on real property and personal property are determined, assessed, and collected differently, but both real and personal property taxes in Michigan are *ad valorem* taxes<sup>[1]</sup> driven by the fair market value of the property subject to tax. For purposes of property taxes, the General Property Tax Act (GPTA) defines fair market value by reference to a property's "true cash value," which is:

The usual selling price at the place where the property to which the term is applied is at the time of assessment, being the price that could be obtained for the property at private sale, and not at auction sale except as otherwise provided in this section, or at forced sale.<sup>[2]</sup>

As a result, valuation is an important consideration in the context of Michigan property tax. In general, the fair market value (or true cash value) of an alternative energy system that qualifies as personal property will be based on its installed/constructed cost, including all materials, labor, and installation costs.<sup>[3]</sup> For real property, the true cash value normally will be determined based on appraisals from a qualified appraiser using the replacement cost, income, and comparable sales approaches.<sup>[4]</sup>

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The GPTA specifically defines "personal property" to include a "wind energy system,"<sup>[5]</sup> but this statutory clarity is lacking for solar and other alternative energy systems. Nevertheless, at its May 13, 2013 meeting, the Michigan State Tax Commission (STC), instructed tax assessors and equalization directors that solar panels should be considered industrial personal property.<sup>[6]</sup> This conclusion is consistent with sound legal and classification principles. Recently, however, a non-binding decision from the Michigan Tax Tribunal determined that solar panels installed on residential real property should be assessed as a part of the real property. See *Mark Clevey & Nancy Fenton v City of Ann Arbor*, Michigan Tax Tribunal Docket No. 17-003056 (March 12, 2018). On February 13, 2018, the STC released a new memorandum rescinding its 2013 guidance and adopting the Tax Tribunal's conclusion regarding solar panels.<sup>[7]</sup> However, in the February 13, 2018 memorandum, the STC specifically limits its new directive to solar panels located on residential real property.<sup>[8]</sup> Thus, for alternative energy producers operating with nonresidential solar operations, the previous uncertainty remains.

## **A. Real Property**

With respect to taxation of real property, the tax base of real property is the property's "taxable value," which is 50 percent of its true cash value (i.e., the tax base is 50 percent of the property's fair market value as determined by the local assessor, or through litigation of the assessor's valuation). This means that the taxable value of real property may increase or decrease in a particular year depending on the local market. Under the provisions of Proposal A<sup>[9]</sup>, the yearly increase in the taxable value of real property is generally limited to the lesser of five percent or the rate of inflation. However, this limitation does not apply when there is an ownership transfer or an addition to the parcel of real property. Such events reset the taxable value of real property to 5 percent of the property's true cash value.<sup>[10]</sup> This process, which occurs whenever there is a transfer of ownership, is known as "uncapping."

An alternative energy producer planning to purchase or lease real property in Michigan should carefully consider the impact of its proposed transaction on the taxable value of the real property. If a purchase transaction will lead to uncapping or other negative tax consequences, the terms of the agreement between the buyer and seller should be negotiated and drafted accordingly. A real property lease should be reviewed for provisions that could trigger an uncapping and should clearly identify which party is responsible for real property taxes, particularly if the lessee's use of the property will result in the loss of favorable tax treatment (e.g., ineligibility for a tax exemption).

## **B. Personal Property**

Like real property, the tax base for personal property is 50 percent of the property's true cash value. A taxpayer is required to file a Personal Property Statement, Form L-4175, with the local taxing jurisdiction to list original cost (original cost of personal property is generally deemed to be fair market value for this purpose) of all personal property located in the jurisdiction. The assessor then applies depreciation factors to the original cost of each type of personal property to arrive at a determined true cash value for the personal property. The depreciation factors normally are provided in the form of multiplier tables published by the STC. The multiplier approach, which serves as a form of depreciation table, is applied because, unlike real property, personal property normally does not increase in value. Although local assessors typically follow STC guidance and multipliers, they are not required to do so.<sup>[11]</sup>

## **C. Real Property Versus Personal Property**

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It is important to distinguish between real and personal property for at least two reasons. First, real property typically is subject to all applicable property taxes in full, while personal property may be subject to lower millage rates, or exempt from certain levies. For example, real property classified as "industrial" or "commercial" normally is subject to tax in full,<sup>[12]</sup> while personal property classified as "industrial" is exempt from up to 18 mills of tax, and "commercial" personal property is exempt from up to 12 mills of tax (an additional six mill exemption is available for certain alternative energy projects pursuant to MCL 211.903(e)).<sup>[13]</sup> Second, real property is assessed through an annual assessor's equalization and assessment based on increasing or decreasing market values,<sup>[14]</sup> while personal property is assessed based on a personal property statement filed by the taxpayer to which the assessor applies depreciation multiplier tables.

The determination of whether property is "real" or "personal" is based on GPTA definitions. Under the GPTA, "real property" is defined to include land, buildings, fixtures on the land; appurtenances to the land; and certain other property set forth in the statute.<sup>[15]</sup> "Personal property" is defined broadly to include all goods, chattels, and effects located within Michigan.<sup>[16]</sup>

In cases in which there is a question whether an item of personal property has become affixed and a part of real property (i.e., has become a "fixture"), or whether the personal property has retained its character as personal, Michigan courts generally apply a three-part test.<sup>[17]</sup> This three-factor test is used to determine whether personal property has become a "fixture" that is properly taxed as real property, and reviews whether there is:

1. Annexation to realty, either actual or constructive;
2. Adaptation or application of the personal property to the use or purpose to which the realty at issue is used; and
3. Intention to make the article of personal property a permanent accession to the land.<sup>[18]</sup>

With respect to assets installed in wind farm and solar energy operations, determinations regarding whether particular items of property are real or personal could be fact-intensive. Importantly, however, Michigan statutory law confirms that a wind energy system (e.g., a wind turbine, including a rotor, an electric generator, a control system, an inverter or other power conditioning unit, and a tower) is personal property.<sup>[19]</sup> Similar analysis should apply to property used in a solar energy project.<sup>[20]</sup>

## **II. Sales and Use Tax**

Michigan applies a six percent sales tax to the total consideration for which tangible personal property is transferred in a sale at retail.<sup>[21]</sup> A "sale at retail" is defined as a "sale, lease, or rental of tangible personal property for any purpose other than for resale, sublease, or subrent." Michigan sales tax law specifically applies sales tax to "the transmission and distribution of electricity, whether the electricity is purchased from the delivering utility or from another provider, if the sale is made to the consumer or user of the electricity for consumption or use rather than for resale."<sup>[22]</sup> Furthermore, Michigan's sales tax statute defines "tangible personal property" as "personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses," including electricity, water, gas, and steam.<sup>[23]</sup> In most cases, the energy produced by an alternative energy system will be taxable when it is sold to the consumer. Despite this general rule, however, there are exceptions, and it is important for alternative energy producers to be familiar with Michigan's sales tax laws. For example, a 501(c)(3) organization or a manufacturer purchasing energy for use in an industrial processing activity may be eligible for a full or partial sales tax

exemption. In addition, while utilities purchased by businesses are subject to six percent sales tax or use tax, utilities purchased for residential use are subject to sales or use tax of only four percent.<sup>[24]</sup>

The Michigan use tax is complementary tax to the sales tax. Like the sales tax, the use tax is levied at a six percent rate, but it is imposed on the use, storage, or consumption of tangible personal property in Michigan.<sup>[25]</sup> The Use Tax Act defines "tangible personal property" to include electricity, water, gas, and steam.<sup>[26]</sup> Typically, use tax is not due when sales tax has already been paid, but the Michigan Department of Treasury requires specific documentation to substantiate the payment of sales tax at the time a product was purchased. *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 853 NW2d 310 (June 23, 2014).

The interaction between sales and use taxes is important to alternative energy producers because both taxing statutes provide an exemption for tangible personal property used or consumed in an industrial processing activity. In general, industrial processing is "the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail . . . ."<sup>[27]</sup> Under this definition, an alternative energy producer may qualify as an industrial processor eligible to purchase certain inputs, machinery, equipment, and tools exempt from sales tax and eligible for a use tax exemption.<sup>[28]</sup>

One of the most significant recent Michigan Supreme Court cases interpreting the industrial processing exemption as it applies to electricity is *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28, 869 NW2d 810 (July 22, 2015). *Detroit Edison*, the taxpayer, claimed a use tax exemption for equipment used to alter and monitor the voltage of electricity within the electric system from the generation plant to the ultimate consumer. The Court held that the industrial process included post-generation activities during transmission and distribution, but granted a partial exemption for certain property that was simultaneously used for non-exempt shipping and distribution. This partial exemption was to be based on the percentage of exempt use of the property to total use as determined by a "reasonable formula or method" approved by the Department.

### III. Corporate Income Tax

Michigan's Corporate Income Tax (CIT) imposes a six percent income tax on the apportioned or allocated taxable income of corporations and entities taxed as corporations for federal tax purposes. For taxpayers subject to tax inside and outside of Michigan, the tax base will be apportioned according to a single sales factor. Sales of tangible personal property, including electricity and gas, are sourced according to the ultimate destination of the property.<sup>[29]</sup>

The Michigan CIT applies a unitary taxation concept. Unitary taxation generally groups commonly controlled and interrelated entities into a single entity for tax purposes. Because of the manner in which unitary taxation can expand the tax base, an alternative energy company seeking to enter the Michigan market<sup>[30]</sup> should thoroughly review its related entities and the activities of those entities. In many cases, ownership structure, entity type, and other considerations provide important tax planning opportunities that are best examined prior to incurring a tax liability.

As the alternative energy sector in Michigan increases in size and influence, the tax laws applicable to the industry will be important factors. Although the specific future direction of these laws remains uncertain, thorough analysis and careful planning by taxpayers and their advisors will be crucial in navigating these uncertainties.

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<sup>[1]</sup> *Meijer Inc v City of Midland*, 240 Mich App 1, 610 NW 2d 242 (2000) (An "ad valorem" tax is "a tax levied on property or an article of commerce in

proportion to its value as determined by assessment or appraisal.").

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<sup>[2]</sup> MCL 211.27(1).

<sup>[3]</sup> See Michigan Form L-4175 (instructions to Section F, p 7: cost of new property is the property's installed cost, including all direct and indirect costs).

<sup>[4]</sup> *Meadowlanes Ltd Dividend Housing Ass'n v City of Hollanda*, 437 Mich 473, 473 NW 2d 636 (1991) (The three traditional methods of determining true cash value are: "(1) the cost-less-depreciation approach, (2) the sales comparison or market approach, and (3) the capitalization-of-income approach.").

<sup>[5]</sup> MCL 211.8(l).

<sup>[6]</sup> See State Tax Commission memorandum dated June 11, 2013 regarding Solar Panels.

<sup>[7]</sup> See State Tax Commission memorandum dated February 13, 2018 regarding Treatment of Residential Solar Panels.

<sup>[8]</sup> *Id.*

<sup>[9]</sup> Proposal A was a constitutional amendment approved by Michigan voters in March of 1994. See Mich Const 1963, art 9, § 3.

<sup>[10]</sup> Mich Const 1963, art 9, § 3.

<sup>[11]</sup> Large energy producers have filed petitions in the Michigan Tax Tribunal contesting local assessors' application of valuation approaches that are inconsistent with STC guidance with respect to alternative energy facilities. These cases are currently pending, but a decision is expected during 2018.

<sup>[12]</sup> Absent an exemption (e.g., agricultural exemption for farm land).

<sup>[13]</sup> See MCL 380.1211.

<sup>[14]</sup> In limited instances, it may be possible for a wind energy system to qualify for a Renewable Energy Renaissance Zone (see PA 376 of 1996) designation, which provides an exemption from real property taxes for a period of up to 15 years.

<sup>[15]</sup> See MCL 211.2(1).

<sup>[16]</sup> See MCL 211.8.

<sup>[17]</sup> *Continental Cablevision of Michigan Inc v Roseville*, 430 Mich 727 (1988).

<sup>[18]</sup> See *Sequist v Fabiano*, 274 Mich 643 (1936); see also, *Wayne Co v Britton Trust*, 454 Mich 608 (1997).

<sup>[19]</sup> MCL 211.8(l).

<sup>[20]</sup> *Id.* See, e.g., STC Memorandum dated June 11, 2013, *supra*.

<sup>[21]</sup> MCL 205.51 and MCL 205.52

<sup>[22]</sup> See MCL 205.52(2).

<sup>[23]</sup> MCL 205.51a(r).

<sup>[24]</sup> See MCL 205.54n and MCL 205.94n.

<sup>[25]</sup> MCL 205.93(1)



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<sup>[27]</sup> MCL 205.94o(7)(a) and MCL 205.54t(7)(a)

<sup>[28]</sup> However, if property purchased exempt from sales tax is later converted to a taxable purpose or is eligible for only partial exemption, the industrial processor is required to self-assess and remit the appropriate use tax directly to the Department. See, e.g., MCL 205.92(b) and MCL 205.97(2).

<sup>[29]</sup> MCL 206.665(a) ("Sales of tangible personal property are in this state if the property is shipped or delivered, or, in the case of electricity and gas, the contract requires the property to be shipped or delivered, to any purchaser within this state based on the ultimate destination at the point that the

property comes to rest regardless of the free on board point or other conditions of the sales.").

<sup>[30]</sup> Michigan nexus, which refers to the minimum connection required before Michigan can impose its tax, exists when a taxpayer has a physical presence in the state for more than one day during the tax year or actively solicits sales in Michigan and has \$350,000 or more in gross receipts sourced

to Michigan. MCL 206.621(1) and MCL 206.623(1). An ownership interest in a flow-through entity that meets these nexus requirements will typically

generate a CIT obligation for the owner of the interest as well.

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