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TOBACCO TAX: BAD DEBTS

House Bill 4855 (Substitute H-2)
First Analysis (5-23-95)

Sponsor: Rep. Kirk A. Profit
Committee: Tax Policy

THE APPARENT PROBLEM:

The General Sales Tax Act allows merchants to deduct the amount of bad debts from gross proceeds in computing the tax that must be remitted to the Department of Treasury. Representatives of tobacco wholesalers have cited this as a precedent that would support proposed legislation that would allow them to deduct bad debts from the taxes they must pay under the new Tobacco Products Tax Act, which took effect on May 1, 1994. They note that the tax has been increased three-fold under the act, which was part of the new school financing system. This increase in the price of the product could lead to increased bad debts. They argue that, as with the sales tax deduction, it is unfair to make them send taxes to the state on transactions for which they themselves ultimately are not paid.

THE CONTENT OF THE BILL:

The bill would amend the Tobacco Products Tax Act to permit a taxpayer (i.e., a wholesaler of tobacco products) to deduct the amount of bad debts from the tax due.

The amount of bad debts deducted would have to be charged off as uncollectible on the books of the taxpayer. If a retailer or other licensee paid all or part of a bad debt for which a deduction had been claimed by a taxpayer, the taxpayer would be liable for the amount of taxes related to that payment and would have to remit them with the next payment to the Department of Treasury.

A claim for a bad debt deduction would have to be supported by evidence as required by the Department of Treasury. The department would have to review any change in the rate of taxation applicable to any transaction by a taxpayer claiming a deduction and ensure that the deduction on any bad debt did not result in the taxpayer recovering any more or less than the taxes imposed attributable to the bad debt.

The term "bad debt" would be defined in the bill. It would refer to any portion of a debt incurred after May 1, 1994, that is related to the tax on the sale of or transfer of a tobacco product that is not otherwise deductible or excludable, that has become worthless or uncollectible in the time period between the date when taxes accrue to the state for the taxpayer's preceding tax return and the date when taxes accrue to the state for the present return or an amount that has become worthless or uncollectible for taxes that accrue to the state after May 1, 1994 and before the first present return filed after the effective date of the bill, and that is eligible to be claimed, or could be eligible to be claimed if the taxpayer kept accounts on an accrual basis as a deduction under the Internal Revenue Code. A bad debt would not include an interest or tax on the purchase price, uncollectible amounts that remain in the possession of the taxpayer until the full purchase price is paid, expenses incurred in attempting to collect any account receivable or any portion of the debt recovered, any accounts receivable that have been sold to a third party for collection, and repossessed property.

MCL 205.427a

FISCAL IMPLICATIONS:

The House Fiscal Agency reports the bill would result in a potential revenue reduction in the range of $250,000 to $500,000. The agency says there is no data available on the magnitude of bad debts from the sale of tobacco products. However, the "bad debt" tax expenditure for sales and use taxes has reduced gross revenues by .06 percent to .07 percent each year, according to Department of Treasury estimates, the agency says. The fiscal agency has anticipated a similar reduction in tobacco tax revenues in making its revenue loss estimate. The HFA points out that a revenue loss of $500,000 would be distributed as follows: school aid fund, $317,000; general fund, $126,500; healthy Michigan fund, $30,000; local health departments, $6,500; and health and safety fund, $20,000. (5-18-95)

ARGUMENTS:

For:

Tobacco wholesalers, who are the taxpayers under the Tobacco Products Tax Act, should not owe taxes to the state on transactions when they do not themselves receive payment. Reportedly, many retailers purchase on credit. Wholesalers must remit taxes monthly on their transactions. But sometimes retailers do not pay their bills. When wholesalers face uncollectible debts (whether due to a bankruptcy or for some other reason), they should be able to deduct them from taxes due. There is precedent for this in the acts governing the sales and use taxes. Also, tax specialists say, businesses can get tax relief for bad debts under federal Internal Revenue Code. Similar relief ought to be available under the act taxing tobacco products.

Against:

This proposal would make the state bear the burden of bad debts between tobacco wholesalers and retailers. It could lead to a significant loss of revenue, including revenue earmarked for schools. It also could lead to a parade of requests for similar exceptions for taxes on other products. At the very least, the legislature needs to delay action on this proposal until its ramifications are fully explored.

POSITIONS:

The Michigan Distributors and Vendors Association supports the bill. (5-19-95)

The Department of Treasury is opposed to the bill. (5-19-95)