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NO PREPAYMENT: SALES, USE TAX

House Bill 4942 (Substitute H-1)
Sponsor: Rep. Penny Crissman

House Bill 5313 (Substitute H-1)
Sponsor: Rep. Kirk A. Profit

Committee: Tax Policy
First Analysis (4-21-98)

THE APPARENT PROBLEM:

As part of a budget deficit reduction package in 1993, businesses collecting large amounts of sales and use taxes were required to begin pre-paying those taxes. Prior to the acts, companies were required to remit taxes on or before the 15th day of the month for taxes imposed in the previous month. (This means taxes collected in January were due February 15.) Public Acts 17 and 18 of 1993 required large taxpayers to remit taxes by the 18th of the month based on 95 percent of the previous year's tax liability for the same month. (Thus, taxes paid on January 18 are for the whole month of January and are calculated based on the company's tax liability in the previous January or, alternatively, on an estimate of the current month's liability. Each month's payment also involves a "reconciliation" of the previous month's accounts; that is, a reconciliation of the amount paid in the previous month with the actual tax liability.) Currently, this requirement applies to taxpayers (e.g., retailers and other businesses) with a combined annual sales and use tax liability of \$720,000 or more. This means the pre-payment requirement applies to businesses remitting at least \$60,000 in taxes per month, which translates into \$1 million per month in sales.

This measure was designed to improve the state's cash flow at a time when revenues were extremely tight. The accelerated payments have reduced the borrowing needs of the state government by about \$5 million or \$6 million per year. At the same time, however, the costs of the taxpayers have increased. In fact, because businesses pay higher interest rates than the state, business pay nearly \$12 million in additional borrowing and capital costs, according to a study commissioned by the Michigan Retailers Association. There are also administrative costs involved in pre-funding tax payments, bringing the total cost to the private sector to \$12.6 million, according to the study by the Anderson Economic Group. Circumstances

have changed. The economy in recent years has generated healthy tax revenues, and the state's businesses believe the pre-payment of sales and use taxes can no longer be justified.

THE CONTENT OF THE BILLS:

The bills would eliminate the provisions that require the "prepayment" of sales and use taxes beginning January 1, 1999. House Bill 4942 would amend the General Sales Tax Act (MCL 205.56). House Bill 5313 would amend the Use Tax Act (MCL 205.94f and 205.96).

The bills would require that businesses remit on or before the 15th of the immediately following calendar month an amount equal to 95 percent of the taxpayer's liability for the same month in the immediately preceding calendar year or 95 percent of the actual liability for the month being reported, plus a reconciliation payment. The reconciliation payment would be equal to the difference between the tax liability determined for the immediately preceding remittance minus the amount of tax previously paid for that month.

Currently, businesses subject to the pre-payment requirement get a collection allowance of three-quarters of one percent of the tax due from the first four cents of the tax (up to \$20,000) if the tax is remitted on or before the 11th of the month and one-half of one percent of the first four cents (up to \$15,000) if the tax is remitted after the 11th day and on or before the 18th of the month. The bills would change the two dates to the 7th day of the month and 15th day of the month, respectively. (These are the dates that currently apply to taxpayers not subject to the pre-payment requirement.)

FISCAL IMPLICATIONS:

The House Fiscal Agency reports that the bills would not affect total state revenues but would increase state cash flow borrowing costs by \$5 million to \$6 million per year. (Fiscal Note dated 3-10-98)

ARGUMENTS:

For:

The original justification for making larger businesses pre-pay sales and use taxes no longer applies. The measure was enacted to help the state's cash flow when state revenues were lagging. The robust economy of the past few years has produced very healthy revenues for the state. It is time now to lift this unfair burden off the businesses that collect the sales and use taxes. While the pre-payment requirement clearly benefits the state, by reducing its need to borrow, it does this by shifting borrowing costs to the private sector. Moreover, according to industry-sponsored studies, pre-payment of sales and use taxes costs the private sector two dollars for every dollar saved by state government. Taxes now must be sent to the state before they are collected. How can this be justified? Owners of lumber yards have pointed out that they often extend credit to their customers in construction, which means that payments (and taxes) are not received until 30, 60, or 90 days after the sales transaction. In addition to carrying these customers, which is a competitive necessity, these business owners are required to accelerate their tax payments; this means, in essence, they are extending credit to the state as well. And businesses that cannot borrow enough to pre-pay their taxes face penalties and interest. Returning to a system similar to that which existed before 1993 would improve the profitability of Michigan businesses.

Against:

A representative from the Department of Treasury told the House Tax Policy Committee that the department wants to continue discussions with business interests over how best to revamp the current sales and use tax collection procedures. The bill before the committee, the department said, would create a dramatic one-time hit to the state's cash flow as a result of the transition to the proposed new payment system. It should be noted that, with the return to the method whereby businesses remit tax collections in the month after taxes are collected, businesses will not only have a tax collection fee but will have the benefit of holding (and investing) the tax money.

POSITIONS:

Among those who have indicated support for this bill to the House Tax Policy Committee are the Michigan Retailers Association; the Michigan Grocers Association; the Michigan Lumber and Building Materials Association; the Michigan Manufacturers Association; the Michigan Restaurant Association; the National Federation of Independent Business; the Michigan Petroleum Association; and Ameritech. (4-1-98)

The Department of Treasury supports the concept but opposes the bill as written. (4-16-98)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.