

PERSONAL PROPERTY TAX: INVENTORY DEFINITION

House Bill 5153 (Substitute H-1) First Analysis (1-12-00)

**Sponsor: Rep. Nancy Cassis
Committee: Tax Policy**

THE APPARENT PROBLEM:

Businesses pay property taxes on personal property to local units of government. The General Property Tax Act, however, exempts the inventory of businesses from the tax and defines "inventory" as 1) the stock of goods held for resale in the regular course of trade of a retail or wholesale business; 2) finished goods, goods in process, and raw materials of a manufacturing business; and c) materials and supplies, including repair parts and fuel. The act specifically provides that "inventory" does not cover personal property under lease or principally intended for lease rather than sale and does not include personal property allowed a deduction or allowance for depreciation or depletion under the federal Internal Revenue Code.

This means goods held by a business for resale are exempt from the personal property tax, but goods held by a business for lease or rent are taxed. However, some firms provide products, notably large heavy construction machinery, on a rental or lease basis for a brief period and then sell them to the same customers, with the rental or lease payments already made counting toward the purchase price. While the company selling the equipment considers the machines as inventory under the law (as goods held for resale) and thus tax-exempt, tax assessors consider them as equipment being rented or under lease, and thus taxable. Sellers of heavy equipment believe this is unfair. They say that the interpretation of what is taxable and not taxable differs from jurisdiction to jurisdiction and that the situation is confusing for companies and their tax administrators. Legislation to address the issue has been introduced.

THE CONTENT OF THE BILL:

The bill would amend the General Property Tax Act to exempt certain personal property intended for resale but which may be leased or rented for up to two years before sale. This would only apply in cases in which the business claiming the exemption 1) derives 50 percent or more of its business income from the sale of

personal property for which an exemption is claimed; and 2) grants a purchaser of the personal property a credit for all lease or rental payments made against the purchase price of the property. The exemption would apply beginning December 31, 1999.

Currently, the act exempts the inventory of businesses and defines "inventory" as 1) the stock of goods held for resale in the regular course of trade of a retail or wholesale business; 2) finished goods, goods in process, and raw materials of a manufacturing business; and c) materials and supplies, including repair parts and fuel.

Specifically, the bill would add to the definition of "inventory" new personal property delivered to a dealer by or on behalf of the manufacturer that is principally intended for resale, which may be leased or rented before sale for a period ending on the earlier of December 31 in the year that the property is sold or two years after the inception of the initial lease or rental agreement for the property.

MCL 211.9c

FISCAL IMPLICATIONS:

The House Fiscal Agency notes that the bill would cause state and local property tax revenues to fall, but the dollar amounts cannot be ascertained at this time. (Fiscal Note dated 12-1-99)

ARGUMENTS:

For:

The bill would clarify what large construction equipment retailers say is currently a grey area. Business inventory -- property intended for resale-- is exempt from the personal property tax. Yet certain property intended for resale is first rented out or leased for a brief period of time, with the rent or lease payments counting against the eventual purchase. This

method of purchasing expensive equipment is often advantageous for companies engaged in heavy construction; the equipment can be very expensive. Equipment sellers consider the property inventory and exempt from tax, but assessors often consider it taxable, since it is property being rented or leased. This leads to conflict and assessment protests. Dealers in heavy construction equipment who rent-to-sell (and who derive the majority of their income from equipment sales) complain that current assessment practices produce an unfair tax burden. They say the personal property tax on such equipment is inconsistently administered by local governments (and personal property is inconsistently reported by companies), leading to inequities. This bill would simply say that if equipment is sold within two years of first being leased or rented and if the lease or rental payments count against the purchase price, then the equipment is to be treated for property tax purposes in the same manner as other equipment intended for resale; that is, it would be exempt. Further, the provision would only apply if the company selling the equipment derived the majority of its income from equipment sales (rather than, say, rentals).

Against:

A number of concerns have been raised about the bill. For one thing, it is not clear what the scope of the bill would be as it is currently written; that is, how many cases it would cover. The fiscal impact on local units of government (and on state education revenues) could be considerable. Also, the bill could cause businesses to change their leasing and purchasing practices so as to fall under the bill and avoid the personal property tax. Note that, under the bill, if a business purchased a piece of equipment outright it would pay personal property tax on it but if it rented the equipment for the first two years, no tax would be due during that period. This could become a large loophole. It could lead to much leased property being tax exempt. Also of concern is how the provision would be administered. Whether or not a piece of equipment was taxable would be based on whether or not it was sold during the next two years. Not only that, but whether a piece of equipment was subject to the property tax would also depend on the nature of a company's business practices (whether the majority of its income was derived from sales of such property). How would local assessors administer this? How would they be able to distinguish taxable from non-taxable equipment?

POSITIONS:

Michigan Tractor and Machinery Co. (also know as Michigan Cat) supports the bill. (1-10-99)

The AUC, Michigan's Heavy Construction Association, supports the bill. (1-10-00)

The Department of Treasury does not support the bill as written but is continuing to examine the issue. (1-10-00)

The Michigan Municipal League is opposed to the bill. (1-6-00)

The Michigan Townships Association is opposed to the bill. (1-7-00)

The Michigan Assessors Association has indicated its opposition to the bill. (12-8-99)

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.