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BILL ANALYSIS

Senate Bills 734 and 773 (as enrolled)
Sponsor: Senator Bill Schuette (S.B. 734)
Senator Dale L. Shugars (S.B. 773)
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACTS 328 and 329 of 2000

Date Completed: 2-2-01

RATIONALE

In Michigan, the sales and use taxes do not apply to food for human consumption, except prepared food intended for immediate consumption. "Prepared food intended for immediate consumption", as defined under the General Sales Tax Act, essentially refers to all food and drink sold in restaurants or other food service establishments where food is prepared and served for immediate consumption either on or off the premises. The application of the sales tax to prepared food intended for immediate consumption extends to free or minimal-cost meals provided by employers to restaurant employees. Under the Michigan Administrative Code, meals provided to employees are taxable (R 205.116). When meals are provided without charge, restaurant (or other food service establishment) owners are required to pay sales tax based upon the actual cost of the meals. (For example, if an employee is given a meal that lists for \$5 on the menu but actually costs \$2, the 6% tax is supposed to be applied to the \$2 cost.)

Apparently, although it is a common custom for restaurants to provide employees with meals for free or a minimal cost while on the job, many restaurant owners are unaware that this benefit is subject to the sales tax. There have been reports of restaurants that, after routine audits by the Department, were presented with substantial tax bills for having failed to pay sales tax on employee meals. Some people feel that, to encourage restaurants to continue providing free or low-cost meals to employees, these meals should be exempt from both the sales and the use taxes.

CONTENT

Senate Bill 734 amends the Use Tax Act, and Senate Bill 773 amends the General Sales Tax Act, to provide that the taxes will not apply to nonalcoholic beverages or prepared food intended for immediate consumption that is provided during work hours for free or at a reduced rate to employees

of food service establishments licensed by the Michigan Department of Agriculture.

The bills will take effect October 1, 2001.

MCL 205.94d (S.B. 734)
205.54g (S.B. 773)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Many restaurant employees work long hours, often at unpopular times of the day and/or the week, for relatively low wages. It is common for restaurants, fast-food establishments, lodging establishments, and other establishments where food is prepared for immediate consumption to provide meals to employees, at no cost or at a minimal cost, as a fringe benefit. Providing meals to employees can have several positive benefits. It can reduce waste, boost morale, engender loyalty among employees, and help employees to be more knowledgeable about the foods they prepare and serve, and thus improve customer service.

The current tax treatment of free or reduced-cost employee meals is counterproductive; in effect punishing restaurant employers for providing a benefit to employees whom they may wish to help and retain. By removing this disincentive, the bills will encourage restaurants to continue the long-standing custom of providing meals to employees.

Opposing Argument

Article 9, Section 8 of the State Constitution states that no sales or use tax shall be levied on the sale or use of food for human consumption, except in the case of prepared food intended for immediate consumption. Clearly, prepared food intended for immediate consumption, whether distributed to customers or employees, is taxable. The bills attempt to reverse this constitutional provision.

Response: Article 9, Section 8 allows the sales or use tax to be applied to “prepared food intended for immediate consumption *as defined by law*” (emphasis added). The General Sales Tax Act contains an extensive definition of prepared food intended for immediate consumption; however, it also specifically exempts certain foods sold under certain conditions, such as juice or milk sold from vending machines. Thus, specifically exempting from the taxes food provided during work hours for free or at a reduced rate to employees of food service establishments does not violate the State Constitution, and is not without precedent.

Legislative Analyst: G. Towne

FISCAL IMPACT

Senate Bills 734 and 773 will reduce sales and use tax revenue by approximately \$7.0 million, beginning in FY 2001-02. This loss in revenue will reduce School Aid Fund revenue \$5.1 million, revenue sharing \$1.7 million, and General Fund/General Purpose revenue \$0.2 million.

Fiscal Analyst: J. Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.