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SFA BILL ANALYSIS

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House Bill 4744 (Substitute H-4 as passed by the House)
Sponsor: Representative Nancy Cassis
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 6-8-99

## CONTENT

**The bill would amend the Use Tax Act to specify that exemptions to the tax allowed under the Act would be based upon exempt use versus total use; include language regarding the apportionment of the tax on telecommunications equipment; expand the industrial processing exemption; create an extracting operations exemption; create a bad debt deduction; and provide for direct payment of the tax to the Department of Treasury under certain circumstances.** The bill is tie-barred to House Bill 4745 and Senate Bill 544. (House Bill 4745 (H-3) would amend the Single Business Tax (SBT) Act to reduce the SBT by .1% per year and make other changes. Senate Bill 544 (H-6) as passed by the House would amend the General Sales Tax Act to place in the Act provisions similar to the amendments proposed by House Bill 4744 (H-4) to the Use Tax Act.)

### Apportionment

The bill specifies that the property or services that are exempt under the Act would be exempt only to the extent that the property or services were used for the exempt purposes, if one were stated in the Act. The exemption would be limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department.

Currently, the Act contains an exemption for property sold to an industrial processor for use or consumption in industrial processing. The bill provides that for property sold to an industrial processor after March 30, 1995, and before March 31, 1999, the property would be exempt only to the extent that it was used for the exempt purposes stated in the bill. The exemption would be limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department.

Currently, the Act exempts the purchase of machinery and equipment for use or consumption in the rendering of services involving interstate or intrastate telephone services, telegraph, leased wire, or other similar communications. The bill provides that, beginning April 1, 1999, the property would be exempt only to the extent that it was used for the exempt purposes stated in the bill. The exemption would be limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department. Further, the bill states the following: "This amendatory act clarifies that, with the exception of telecommunications equipment taxed under... [the Act], the tax levied does not apply to the price of property or services except to the extent that the property or services are stored, used, or consumed for exempt purposes. For telecommunications equipment taxed under... [the Act], this amendatory act clarifies that for periods before April 1, 1999, the tax shall not be apportioned and for periods beginning April 1, 1999, the tax shall be apportioned. This amendatory act clarifies that existing law as originally intended provides for a prorated exemption. This amendatory act takes effect for all periods beginning March 31, 1995 and all tax years that are open under the statute of limitations provided in section 27a of 1941 PA 122" (the revenue Act).

### Industrial Processing Exemption

The bill would provide for a revised and expanded industrial processing exemption for property sold after March 30, 1999. The tax would not apply to property sold to an industrial processor for use or consumption in industrial processing; a person, whether or not the person was an industrial processor, if the tangible personal property were intended for ultimate use in and were used in industrial processing by an industrial processor; a person, whether or not the person was an industrial processor, if the tangible personal property were used by that person to perform an industrial processing activity for or on behalf of an industrial processor; and a person, whether or not the person was an industrial processor, if the tangible personal property were one of several types of equipment used in computer assisted manufacturing, design, and engineering systems as listed in the bill. The property would be exempt only to the extent that it was used for the exempt purpose stated in the bill. The exemption would be limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department.

The bill specifies the types of property that would be considered eligible or ineligible for the industrial processing exemption.

Under the bill, "industrial processing" would mean 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 or for use in the manufacturing of a product to be ultimately sold at retail. Industrial processing would begin when tangible personal property began movement from raw materials storage to begin industrial processing and would end when finished goods first came to rest in inventory storage.

Extractor Operations

The bill would exempt from the tax property sold to an extractive operator for use or consumption in "extractive operations", that is, the activity of taking or extracting for resale ore, oil, gas, coal, timber, stone, gravel, clay, minerals, or other natural resource material. It would begin when contact was made with the actual type of natural raw product being recovered, and would include all necessary processing operations before shipment from the place of extraction. The bill lists the types of property that would be eligible or ineligible for the exemption.

Bad Debt Deduction

The bill provides that beginning March 30, 1995, in computing the amount of tax levied for any month, a seller could deduct the amount of bad debts; that is, any portion of a debt resulting from a seller's collection of the use tax on the purchase of tangible personal property or services that was not otherwise deductible or excludable, that had become worthless or uncollectible between the date when taxes accrued to the State for the seller's preceding use tax return and the date when taxes accrued to the State for the present return, and that was eligible to be claimed, or could be eligible to be claimed as a deduction under the Internal Revenue Code. Any claim for a bad debt deduction would have to be supported by evidence as required by the Department.

Direct Payment

Under the bill, the Revenue Commissioner, at his or her discretion, could authorize a person to assume the obligation of self-accruing and remitting use tax due on purchases or leases directly to the Department under a direct payment authorization, under conditions specified in the bill.

MCL 205.93 et al. Legislative Analyst: G. Towne

**FISCAL IMPACT**

This bill would generate $188 million in use tax revenue in FY 1998-99 by allowing the industrial processing exemption to be apportioned based on the amount of time equipment was used for exempt versus nonexempt purposes. The consensus revenue estimates for FY 1998-99 and FY 1999-2000 include estimates of the loss in revenue that will occur under current law due to the Michigan Bell court decision. The proposed change to allow the apportionment of the industrial processing exemption would fix the court-identified problem and, therefore, use tax revenue losses currently built into the consensus revenue estimates would not occur and use tax revenue would be increased. In FY 1999-2000, the proposal to apportion the industrial processing exemption would increase the current use tax revenue estimates $48 million, but a proposal to expand the industrial processing exemption would reduce use tax revenue an estimated $18 million, for a net revenue gain of $30 million. These estimated fiscal impacts would affect both the General Fund/General Purpsose and School Aid Fund budgets. This bill is included in a package of business tax changes and the estimated fiscal impact of this total package is summarized in the following table.

**Estimated Fiscal Impact of Business Tax Package: FY 1998-99 and FY 1999-2000**

(dollars in millions)

| Tax/Major Proposed Changes: | FY 1998-99 GF/GP | FY 1998-99 SAF | FY 1998-99 Total | FY 1999-2000 GF/GP | FY 1999-2000 SAF | FY 1999-2000 Total |
|---|---|---|---|---|---|---|
| HB 4745 - Single Business Tax | | | | | | |
| o Reduce tax rate 0.1%/year. | $(86.80) | $0.00 | $(86.80) | $(210.90) | $0.00 | $(210.90) |
| o Replace CAD with ITC. | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Subtotal HB 4745 | (86.8) | 0.0 | (86.8) | (210.9) | 0.0 | (210.9) |
| HB 4744 - Use Tax | | | | | | |
| o Expand industrial processing exemption. | 0.0 | 0.0 | 0.0 | (12.3) | (6.1) | (18.4) |
| o Michigan Bell fix. * | 125.3 | 62.7 | 188.0 | 32.0 | 16.0 | 48.0 |
| Subtotal HB 4744 | 125.3 | 62.7 | 188.0 | 19.7 | 9.9 | 29.6 |
| HB 4586 - Use Tax | | | | | | |
| o Extend and expand rolling stock exemption. | (0.1) | 0.0 | (0.1) | (0.2) | (0.1) | (0.3) |
| SB 544 - Sales Tax | | | | | | |
| o Expand industrial processing exemption. | 0.0 | 0.0 | 0.0 | (1.2) | (3.4) | (4.6) |
| o Michigan Bell fix. * | 12.6 | 34.5 | 47.1 | 3.2 | 8.8 | 12.0 |
| o Extend and expand rolling stock exemption. | (0.9) | (3.1) | (4.0) | (2.3) | (7.8) | (10.1) |
| Subtotal SB 544 | 11.7 | 31.4 | 43.1 | (0.3) | (2.4) | (2.7) |
| Total Business Tax Package | $50.1 | $94.1 | $144.2 | $(191.7) | $7.4 | $(184.3) |

*Consensus revenue estimates for FY 99 and FY 2000 include estimates of the tax loss that will result from the Michigan Bell court case. These proposed legislative changes would fix the court-identified problem and therefore, these revenue gains would offset the revenue losses contained in the consensus estimates.

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.