



**House  
Legislative  
Analysis  
Section**

House Office Building, 9 South  
Lansing, Michigan 48909  
Phone: 517/373-6466

**TOBACCO TAX: BAD DEBT  
DEDUCTION**

**Senate Bill 1396 as passed by the Senate  
First Analysis (11-12-02)**

**Sponsor: Sen. Joanne G. Emmons  
House Committee: Tax Policy  
Senate Committee: Commerce**

***THE APPARENT PROBLEM:***

Both the General Sales Tax Act and the Use Tax Act allow merchants to deduct the amount of bad debts from gross proceeds in computing the tax they must remit to the Department of Treasury. The Tobacco Products Tax Act, however, does not allow a similar deduction for the tobacco wholesalers who are responsible for collecting and remitting tobacco taxes. Tobacco distributors and vendors argue that the inconsistent bad debt policy ought to be corrected. The lack of a bad debt deduction is particularly burdensome for wholesalers now because the tobacco tax has recently been increased substantially, with the cigarette tax raised by 50 cents per pack to \$1.25 per pack. This is also a troubled time for retailers of tobacco (and other products), say industry representatives, and increased economic difficulties, including bankruptcies and business failures, lead to more bad debts. It can be a great hardship for wholesalers to have to remit to the state taxes due on sales for which they have not been paid by retailers.

***THE CONTENT OF THE BILL:***

The bill would amend the Tobacco Products Tax Act to allow businesses that collect and remit the tax to deduct the amount of bad debts beginning January 1, 2003. (The businesses, typically wholesalers, are referred to in the act as "licensees".) The amount deducted would have to be charged off as uncollectible on the books of the licensee.

Any claim for a bad debt deduction would have to be supported by a copy of the original invoice; evidence that the tobacco products described in the invoice were delivered to the person who ordered them; and evidence that the person who ordered and received the tobacco products did not pay the licensee and that the licensee used reasonable collection practices in attempting to collect the debt. If part or all of a bad debt was later paid, the licensee would be liable for

the amount of taxes deducted and would have to remit them to the Department of Treasury.

The definition of "bad debt" in the bill is similar to the definition of that term found in both the General Sales Tax Act and the Use Tax Act. It would refer to the taxes attributable to any portion of a debt related to a sale of tobacco products that had become worthless or uncollectible in the time period between when taxes accrued to the state for the licensee's preceding tax return and the date when taxes accrued to the state for the licensee's present return that were eligible to be claimed as a deduction under Section 166 of the federal Internal Revenue Code (or that would be eligible if the licensee kept accounts on an accrual basis). A bad debt would not include any interest on the wholesale price of a tobacco product, uncollectible amounts on property that remained in the possession of the licensee until the full purchase price was paid, expenses incurred in attempting to collect any account receivable or any portion of the debt recovered, any amounts receivable that had been sold to a third party, or repossessed property.

MCL 205.427b

***BACKGROUND INFORMATION:***

Public Act 503 of 2002 (House Bill 5248) raised the tax on cigarettes from 75 cents per pack (of 20 cigarettes) to \$1.25 per pack and increased the tax on other tobacco products (cigars, noncigarette smoking tobacco, and smokeless tobacco) from 16 percent of the wholesale price to 20 percent of the wholesale price. At the same time, Public Act 503 increased the collection fee for wholesalers for collecting the tax on cigarettes to 1.5 percent from 1.25 percent. The collection fee for other tobacco taxes remained at 1 percent. The tax increase and collection fee increase took effect August 1, 2002.

Senate Bill 1396 (11-12-02)

***FISCAL IMPLICATIONS:***

The House Fiscal Agency reports that, on average, the bill would reduce tobacco tax revenue by about \$1 million per year. The HFA notes that nearly 55 percent of tobacco tax revenue is earmarked to the School Aid Fund; nearly 33 percent goes to the general fund; and the remainder is distributed to the Healthy Michigan Fund, the Medicaid Trust Fund, and local governments. (HFA analysis dated 11-6-02)

***ARGUMENTS:******For:***

The bill would put into the Tobacco Products Tax Act the same bad debt provision already found in the General Sales Tax Act and the Use Tax Act. It is a matter of consistency and fairness. Tobacco wholesalers should not have to remit taxes to the state when they have not themselves been paid by their customers. Given the high tobacco tax in the state, this can be a severe hardship. This bill would allow wholesalers a deduction when they face uncollectible debts (despite their good faith efforts to collect). Industry representatives say the tobacco tax is due when the wholesaler invoices the retailer for the product. Remember, the wholesalers collect the tax on behalf of the state but they are not the taxpayer. Wholesalers often remit the taxes due before they are paid by retailers (because of payment arrangements between wholesalers and retailers). Under current tax policy, if they subsequently do not get paid, they do not get a credit for the taxes already paid on the bad debt. This bill would remedy the situation.

***POSITIONS:***

The Department of Treasury supports the bill. (11-7-02)

Michigan Distributors and Vendors Association, Inc. supports the bill. (11-7-02)

S. Abraham & Sons, Inc. supports the bill. (11-7-02)

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.