

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA**BILL ANALYSIS**

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1396 (as enrolled)
Sponsor: Senator Joanne G. Emmons
Committee: Finance

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RATIONALE

The Tobacco Products Tax Act levies a tax on all tobacco products sold in Michigan, and states an intent to impose the tax upon the consumer of the tobacco products. Like the sales tax, the tobacco tax is added to the price of the product and collected by the retailer. Rather than collecting the tobacco tax from the thousands of retailers and vendors across Michigan, however, the Department of Treasury requires wholesalers to pay the tax to the State when tobacco products are transferred to a retailer, as provided in the Act.

Wholesalers typically have agreements with retailers regarding payment of the retailers' accounts, which usually involve many products other than tobacco. This means that a wholesaler often pays the tobacco products tax before the retailer has sold the product, collected the tax from the customer, and remitted the tax to the wholesaler. It has been pointed out that if a retailer goes out of business, or for some reason is unable to pay the tax to the wholesaler, the State does not credit or reimburse the wholesaler for taxes it already paid but cannot collect. It has been suggested that a wholesaler be allowed to deduct from the tobacco products tax, taxes on tobacco products that the wholesaler paid but could not collect.

CONTENT

The bill would amend the Tobacco Products Tax Act to allow a licensee to deduct bad debts from the tax levied on tobacco products under the Act, beginning January 1, 2003.

(The Act prohibits a person from purchasing, possessing, acquiring for resale, or selling a

tobacco product as a manufacturer, wholesaler, secondary wholesaler, vending machine operator, unclassified acquirer, transportation company, or transporter in the State unless licensed to do so. Tobacco products are cigarettes, cigars, noncigarette smoking tobacco, and smokeless tobacco.)

Under the bill, if a licensee deducted bad debts from the tax, the amount deducted would have to be charged off as uncollectible on the books of the licensee. If a person paid all or part of a bad debt with respect to which a licensee claimed a deduction, the licensee would be liable for the amount of taxes deducted in connection with that portion of the debt for which payment was received, and would have to remit the taxes in his or her next payment to the Department of Treasury.

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 had not paid the licensee, and that the licensee used reasonable collection practices in attempting to collect the debt.

Under the bill, "bad debt" would mean the taxes attributable to any portion of a debt that was related to a sale of tobacco products subject to the tax that was not otherwise deductible or excludable; that had become worthless or uncollectible in the time period between the date when taxes accrued to the State for the licensee's preceding 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

if the licensee kept accounts on an accrual basis, as a deduction pursuant to a section of the Internal Revenue Code. 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 accounts receivable that had been sold to a third party for collection, or repossessed property.

Proposed MCL 205.427b

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

In effect, tobacco wholesalers are the State's tax collectors for the tax on tobacco products. There are approximately 50 licensed tobacco wholesalers in the State, many of which sell hundreds of products other than tobacco to retailers across Michigan. While tobacco products may account for a small percentage of a wholesaler's complete inventory, they can represent the majority of the wholesaler's annual revenues. A wholesaler must pay the tobacco products tax to the Department of Treasury when the wholesaler transfers the tobacco products to a retailer; however, by agreement with the wholesaler, the retailer may not be required to remit the tax to the wholesaler at that time, but instead at a time more convenient to the retailer, such as after the product is sold and the tax is collected from the customer. This system puts the wholesaler at risk. If the wholesaler is unable to collect the tax from the retailer, or unable to recover the tobacco products, the wholesaler has lost the tax paid to the State, which is not required to reimburse or give credit to the wholesaler. This is unfair to the wholesaler, and can be particularly damaging if the wholesaler's retail customer is a large business (e.g., K Mart). By allowing a wholesaler to deduct tobacco products tax it paid to the Department but was unable to collect from a retailer, the bill would help wholesalers to avoid losses that cannot be avoided under the current system.

Legislative Analyst: George Towne

FISCAL IMPACT

It is estimated that this bill would reduce cigarette and other tobacco tax revenue by less than \$1 million for a typical year; however, in any given year, the loss in revenue could be much larger if one or more large retailers were to go out of business. This loss in revenue would be distributed as follows: 54% to the School Aid Fund, 33% to the General Fund, 6% to the Healthy Michigan Fund, 3% to the Medicaid Trust Fund, and 4% to local governments.

Fiscal Analyst: Jay 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.