Legislative Analysis

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EXCLUDE SALES TAX FROM GASOLINE WHEN PRICE AT PUMP EXCEEDS $2.30

House Bill 5211 as introduced
Sponsor: Rep. Robert Gosselin
Committee: Tax Policy

First Analysis (7-5-06)

BRIEF SUMMARY: The bill would exempt the amount of the sale price of gasoline exceeding $1.99 per gallon (before the imposition of state taxes) from the sales tax. As a practical matter, this would mean that no state sales tax would be charged on a gallon of gasoline for the amount of the price exceeding $2.30 at the pump.

FISCAL IMPACT: The fiscal impact cannot be determined with any certainty because the future price of gasoline (and thus, the amount that would be exempt from the sale tax) is not known. However, if the price of gasoline averaged $3.00 per gallon for an entire year, the bill would reduce the sales tax by $0.04 per gallon, resulting in an estimated revenue loss likely exceeding $190 million. This would represent a loss of more than $140 million to the School Aid Fund, almost $20 million to Constitutional Revenue Sharing, and $7.6 million to the Comprehensive Transportation Fund. The remaining $32.3 million reduction would come from the General Fund.

THE APPARENT PROBLEM:

Gas prices in Michigan and throughout the nation are up and are now at near-record levels. The statewide average price of gasoline in May 2006 was $2.856, according to AAA Michigan. That compares to a per-gallon average of $2.150 in May 2005 and $1.985 in May 2004. Further, average weekly prices have increased nearly 50 cents since the start of the year, and are not expected to recede dramatically now that the summer driving season is here and refiners start producing cleaner summer blends.

The reasons for the continued increase in gasoline prices are varied and are largely out of the control of the state government or individual consumers. Experts say that gasoline prices are at near-record levels in great part because of continued political unrest in the world's oil producing regions and increasing worldwide demand.

Higher gas prices directly affect drivers and businesses. As gas prices continue to increase, consumers have fewer dollars to spend on other items, such as groceries and utilities, and look for other ways of cutting back on their gasoline consumption or other household expenses. Moreover, businesses are faced with increased costs, which can be substantial, because of higher fuel prices; these prices are absorbed through diminished profits or employee wages or passed on to consumers through higher prices. When gas prices are high, service stations often see significant drops in sales of non-gasoline items such as beverages and food.

With people having little choice but to pay more for gas, and with there being little the state can do in terms of affecting the base price of a gallon of gas, some people have suggested the state influence gas prices through tax policy. The state imposes the six percent sales tax and a 19-cent excise tax on gasoline sales. Legislation has been introduced to exempt a portion of gasoline sales from the sales tax when prices increase above a certain level.

THE CONTENT OF THE BILL:

The bill would amend the General Sales Tax Act (MCL 205.54a) to exempt from taxation, the amount of the sales price of a gallon of gasoline that exceeds $1.99 per gallon. This would effectively cap the amount of sales tax collected at 12 cents per gallon.

Currently, the federal government imposes an excise tax of 18.4 cents per gallon of gasoline, and the state imposes an excise tax of 19 cents per gallon. The sales tax is imposed on sales of gasoline, including the federal gas tax, but excluding the state gas tax. The "sales price" of $1.99 per gallon referenced in the bill would be the pre-tax price for a gallon ($1.806) and the federal gas tax. Added to that cost would be 12 cents in sales tax ($1.99 X 6%), and the 19 cents for the state gas tax. The bill, then, would apply to gasoline with a retail selling price (price at the pump) exceeding $2.30 per gallon, as follows:

$2.30 = $0.19 [State Gas Tax] + $0.184 [Federal Gas Tax] + $0.12 [Sales Tax] + $1.806 [Pre-tax Price]

BACKGROUND INFORMATION:

Sales Tax Calculation

The price at the pump is a tax inclusive price, and the more accurate method of calculating the amount of sales tax paid for a gallon is:

$$\frac{\text{Pump Price} - \text{State Gas Tax}}{17.6667}$$

At $2.30 per gallon, that amount of sales tax is $0.1194 ($.12): ($2.30 - $0.19) ÷ 17.6667. From that, the "sales price" (i.e., the amount to which the sales tax is applied) calculates out to be $1.99 ($0.1194 ÷ 0.06).

Previous Legislation

The bill is a re-introduction of House Bill 4204 of the current session. The original version of House Bill 4204, also introduced by Rep. Gosselin, is identical to House Bill 5211. The House-passed version of the House Bill 4204 would permit the governor to issue an executive order exempting the sale of gasoline and diesel fuel from the sales tax. The bill passed the House on September 6, 2005, and is currently pending before the Senate Committee on Government Operations. At the time, the House Fiscal Agency estimated that if gas prices were $3.00 per gallon, the bill would reduce sales tax revenue $790 million on a full year basis.

As a point of reference, the when House Bill 4204 was reported from the House Committee on Tax Policy on March 23, 2005 the statewide average for a gallon of regular unleaded gasoline for that week was $2.136. The price of the same period a year earlier was $1.739. When the bill passed the House in early September – in the wake of Hurricane Katrina - the average price for that week was $3.048.

Further Reading

The Citizens Research Council recently issued a report discussing the impact of taxation on gasoline in Michigan. The report, and other publications, is available through the CRC's website at http://www.crcmich.org.

In addition, the Senate Fiscal Agency has issued a memo to Senate members concerning the sales tax and gasoline on May 1, 2006. The memo is available through the SFA's website at http://www.senate.michigan.gov/sfa/Publications/Memos/Mem0501.pdf.

The bill also reduces funding to the Comprehensive Transportation Fund (CTF). For further information on the revenue issues facing the CTF and state support for public transit programs, see the following memos from the House Fiscal Agency:

- http://www.house.mi.gov/hfa/PDFs/transit%20issues.pdf
- http://www.house.mi.gov/hfa/PDFs/CTF%20analysis.pdf

ARGUMENTS:

For:

By exempting a portion of the cost of a gallon of gasoline, the bill provides Michigan taxpayers (individuals and businesses) with some much-needed tax and price relief as gas prices continue to increase. With the cost of a gallon of gasoline at near-record levels, Michigan motorists are facing greater financial pressure as they continue to pay utilities, the rent or mortgage, and other necessary household or business expenses. Moreover, the taxpayer must pay the sales tax on top of the federal gas tax, which amounts to double taxation and further increases the price of gasoline to consumers. (Some people question the practice of applying taxes on other taxes, and other legislation to prevent this has been introduced.)

The cost of higher gas prices translates to higher prices for good and services. Limiting the sales tax is one way state government can help reduce the burden. With this proposal, the state will forego collecting a windfall from higher gasoline taxes.

Response:

Why not include diesel fuel as well? A great number of individuals and businesses use diesel fuel, and would not receive a price break. Is this fair? The price of a gallon of diesel fuel now exceeds the price of a regular unleaded gasoline, according to recent price data from AAA Michigan.

Further, the bill makes no distinction between the various grades of fuel sold, and provides more relief to individuals purchasing "premium" gasoline. It could be argued that this is a group of consumers for whom the cost of gasoline is less of an issue than for purchasers of "regular" gasoline.

Against:

The bill provides individual taxpayers with very little tax relief while depriving schools and local governments of significant revenue. When a gallon of gas retails for $2.30, that price includes 12 cents in sales taxes. When the cost of a gallon increases to $3.00, that price includes 16 cents in sales tax. Under the bill, then, the taxpayer would save four cents on that gallon. A taxpayer who drives 15,000 miles in a year in a vehicle that averages 25 miles per gallon would save about $24 if gas prices were to stay around $3.00 per gallon for the year. Plus, it would be hard to determine if the savings were actually passed on to the consumer or simply retained by the gasoline industry.

While the amount a consumer would save is inconsequential, the financial impact on schools and local governmental units is much more real and significant and, moreover, would come at a time when school and local governments must deal with other financial constraints brought on by an ailing state budget and lackluster state economy (not to mention the impact of higher fuel prices). Critics say that considering the small benefit to consumers and the large losses of tax revenue, it doesn't make sense to enact this bill.

School representatives say that with the passage of Proposal A, voters expressed a preference for sales taxes to finance schools over property taxes; to the extent the reduction in sales tax revenue forces schools to seek property tax increases, the bill goes against the principles of Proposal A.

Supporters of public transit have also expressed opposition to the bill given that the bill would reduce funding for the Comprehensive Transportation Fund by an estimated $7.6 million; the CTF assists transit programs (e.g., transportation-to-work), intercity bus, rail passenger, rail freight programs, and the 79 local public transit agencies.

Response:

Businesses also pay this additional tax and, for them, the cost can be substantial. The higher tax burden paid by large users of fuel is reflected in the cost of goods and services charged to consumers, in diminished profits, and in reduced employee wages or lost jobs. The tax reduction would provide real relief throughout the economy.

Furthermore, the revenues "lost" to government should be seen as "windfall" revenues. These are not revenues schools and local government would receive if gasoline prices were not at such extreme levels. The bill is not taking away revenues through a rate reduction or budget cuts; it is capping a tax at a price level that still allows government to collect a significant amount of revenue from the sale of gasoline.

Rebuttal:

Recent sales tax collection data clearly show that the state is not receiving a "windfall" from higher gas prices. Fiscal Year-to-date sales tax revenue growth is flat, compared to the same time period last year, even though gas prices have steadily risen. (See the HFA's May 2006 Revenue Review at http://house.michigan.gov/hfa/PDFs/revmay06.pdf) A recent report from the non-partisan Citizen's Research Council concludes, "While rising gasoline prices may increase sales tax revenues on gasoline purchases, overall tax revenues appear unaffected. Consumer buying decisions and household budget constraints cause people to substitute other taxable purchases to satisfy their gasoline consumption, which is now relatively more expensive. Basic microeconomic principles suggest that rising gasoline prices do not result in surplus tax revenue."

Moreover it is a bad precedent to apply the sales tax unevenly in this way: a variable amount based on the price of goods. The "slippery slope" question is, why not apply the policy to other goods as well?

Against:

The bill reportedly creates administrative problems for the Department of Treasury. Purchasers of gasoline from a refiner or pipeline terminal operator must prepay the sales tax equal to six percent of the statewide average retail price of a gallon of self-service unleaded regular gasoline, as determined by the department. (Pursuant to Revenue Administrative Bulletin 2006-2, effective May 1, 2006, that rate was increased from 9.9 cents per gallon to 12.7 cents.) The bill would require the department to rebate retailers for the exempted potion of gasoline sales. Also, the Department of Treasury testified previously that the exemption could put the state out of compliance with the Streamlined Sales Tax Project, which the state only recently joined. The project is intended to ease sales and use tax collection by businesses partly by creating uniformity among the states in terms of what is taxable and how the tax is administered.

POSITIONS:

The Associated Food and Petroleum Dealers are neutral on the bill. (5-31-06)

The Department of Treasury opposes the bill. (5-31-06)

Public Education Advocates opposes the bill. (5-31-06)

The Michigan Education Association opposes the bill. (5-31-06)

Michigan American Federation of Teachers – Michigan opposes the bill. (5-31-06)

The Michigan Small and Rural Schools Association opposes the bill. (5-31-06)

The Michigan Municipal League opposes the bill. (5-31-06)

The Michigan Townships Association opposes the bill. (5-31-06)

The Amalgamated Transit Union opposes the bill. (5-31-06)

The Allegan County ISD opposes the bill. (5-31-06)

The Bay-Arenac ISD opposes the bill. (5-31-06)

The Huron ISD opposes the bill. (5-31-06)

The Kalamazoo RESA opposes the bill. (5-31-06)

The Muskegon Area ISD opposes the bill. (5-31-06)

The Ottawa Area ISD opposes the bill. (5-31-06)

The Traverse City Public Schools opposes the bill. (5-31-06)

The Tuscola ISD opposes the bill. (5-31-06)

The Wayne RESA opposes the bill. (5-31-06)

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