

Legislative Analysis



MOTOR VEHICLES: SALES TAX ON THE DIFFERENCE

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House Bill 4373 (Substitute H-1)
Sponsor: Rep. Marc Corriveau

House Bill 4514 (Substitute H-1)
Sponsor: Rep. Terry Brown
Committee: Tax Policy

Complete to 4-13-07

A SUMMARY OF HOUSE BILLS 4373 (H-1) & 4514 (H-1) AS REPORTED FROM COMMITTEE

As part of her Fiscal Year 2008 Executive Budget, Governor Granholm has recommended that the sales tax be imposed on the difference between a new vehicle's selling price and the value of any trade-in vehicle. This change, the administration contends, "will encourage new vehicle purchases in Michigan and bring another part of Michigan's tax structure in line with nearly all other states."

House Bills 4373 (H-1) and 4514 (H-1) would amend the General Sales Tax Act (MCL 205.51) and Use Tax Act (MCL 205.92), respectively, to provide a trade-in allowance for new vehicle sales and leases, so that the sales or use tax would be imposed on the difference between the new vehicle's sales (purchase) price and the agreed-upon value of the prior vehicle. A "new" motor vehicle would be one (as defined in the Michigan Vehicle Code) that is not a demonstration vehicle, leased vehicle, manufacturer's vehicle, or a used vehicle. (See Background Information for specific definitions.)

In the bill as introduced, a new motor vehicle was defined to be one that has been driven fewer than 300 miles. The revised definition of "new motor vehicle" creates an apparent incongruity in House Bill 4514, which specifically refers to motor vehicle leases. House Bill 4514 is tie-barred to House Bill 4373.

FISCAL IMPACT:

The fiscal impact of these bills depends on the number of new vehicles sold or leased, the new vehicle price, and the agreed-upon value of any trade-in vehicle. The annual estimated fiscal impact of these bills is a reduction of revenue between \$160 million and \$175 million. Given the earmarking of the sales tax and the use tax and using the \$160 million estimate, these bills would reduce revenue to the School Aid Fund by \$114 million, revenue sharing by \$30 million, General Fund/General Purpose by \$9 million, and the Comprehensive Transportation Fund by \$7 million.

BACKGROUND INFORMATION:

Definitions

The bill incorporates the definition of "new motor vehicle" from the Michigan Vehicle Code (MCL 257.33a), which defines "new motor vehicle" to mean a motor vehicle that is not and has not been a demonstrator, executive or manufacturer's vehicle, leased vehicle, or used or second hand vehicle. A "demonstrator" (MCL 257.11a) is a motor vehicle used by a prospective customer or a motor vehicle dealer (or an agent) for testing and demonstration purposes. An "executive or manufacturer's vehicle" (MCL 257.14a) is a motor vehicle provided by a manufacturer for the use and possession of an employee of the manufacturer, which is titled to the manufacturer, or which is driven with special manufacturer's license plates. A "leased vehicle" (MCL 257.24a) is a motor vehicle for which a person is granted possession for a contracted period of time for a contracted sum in return.

Prior Legislation

Michigan briefly allowed a trade-in allowance (against the sales and use taxes) for new and used vehicle sales and leases once before—from January 1, 1984 to February 1, 1985 (see Public Acts 218 and 219 of 1982). As first enacted, Public Act 218 provided the tax break indefinitely. However, concerns about the potential loss of revenue led to the enactment of subsequent legislation to end the tax break on February 1, 1985.

The tax treatment of trade-in vehicles has been a longstanding issue within the General Sales Tax Act. In 1936, three years after the act took effect, the Attorney General, in response to a question from then-Governor Frank Fitzgerald as to whether the sales tax applied to the cash received as well as the trade-in value of vehicle used as partial payment, opined that "it is readily apparent that the sale tax as applied to one engaged in the business of making sales at retail is not merely assessed as against the cash received by the seller, but is imposed upon the amount received by him in either money or property or both, and therefore the tax must be paid upon the aggregate amount received by the seller from each sell." Curiously, the Attorney General added, "[t]here can be no question but what this is [is] an exaction, and probably was never in contemplation of the Legislature at the time of passage of this act. The situation should be remedied at the next session of the Legislature."¹

¹ See OAG No. 157, 1935-1936; April 8, 1936. The opinion used the following example to show how motor vehicle sales were treated under the sales tax: A dealer sells a vehicle for \$1,200 receiving \$400 in cash and used vehicle valued at \$800, and paying the then-3% sales tax of \$36. The dealer then sells the second vehicle for \$800 receiving \$300 in cash and a used vehicle valued at \$500, and paying the sales tax of \$24. The dealer then sells the third vehicle for \$500, receiving \$200 in cash and receiving a used vehicle valued at \$300 and paying sales tax of \$15. In all, in this example, the dealer received \$900 in cash and a used vehicle valued at \$300 and paid \$75 in sales taxes. This equates to a rate of 8.33% ($\$75 \div \900), which the Attorney General opined was probably not what the legislature intended. The attorney general suggested that the law be amended to impose the sales tax on cash received. There were prior and subsequent opinions (March 8, 1935 and August 6, 1937) by other attorneys general also of the opinion that a trade-in allowance was not allowed under the act.

Value of the Trade-In Vehicle

The bill provides that the value of the trade-in vehicle would be its "agreed-upon" value. Section 11 of the General Sales Tax Act (MCL 205.61) states that in a taxable sale at retail of a motor vehicle where another vehicle is used as partial payment of the purchase price, the value of the trade-in is that value agreed to by the parties to the sale as evidenced by the signed statement executed under Section 251 of the Michigan Vehicle Code (1949 PA 300, MCL 257.251). This provision was added with the enactment of Public Act 173 of 2004 as part of the Streamlined Sales Tax Project, an effort among the states to simplify and modernize sales and use tax collection and administration as a means of reducing the burden of collecting those taxes on sellers, thereby increasing compliance with the taxes.

Sales and Use Tax Rules

Rule 15 of the Department of Treasury's General Sales and Use Tax Rules (R 205.15) provides that sales tax applies to the full selling price, with no deduction from the gross proceeds of a sale permitted for any credit allowed by the seller for a trade-in taken in exchange or partial payment. Section 1 of the General Sales Tax Act (MCL 205.51) excludes from "sales price" the value of any trade-in credit.

Rule 4 of the Specific Sales and Use Tax Rules (R 205.54) states, "sales of new and used automobiles, buses, trucks, tractors, trailers, housetrailer, motorcycles, motor scooters, and other vehicles for consumption or use are subject to the tax on the full original retail sales price without any deductions for federal taxes, freight, handling, delivery, commissions, trade-ins, repossessions, advertising, future free service, or any expense incurred as part of the cost of doing business."

Tax Treatment of Leased Vehicles

Generally, when a vehicle is leased, a leasing company (e.g. Ford Motor Credit or GMAC) that has a use tax registration with the Department of Treasury has the option to pay the use tax at the time of title application or pay the use tax on monthly receipts. A down payment (capitalized cost reduction) included as part of a lease agreement and used to lower the monthly lease payment is considered by the Department of Treasury to be the first lease payment and is subject to the use tax. A dealer acting on behalf of a leasing company may collect the use tax and remit it on the dealer's monthly sales, use, and withholding tax return. If a lessee elects to purchase the vehicle at the end of the lease contract (or if the leasing company sells the vehicle to a third party), the leasing company, if not a licensed dealer, collects sales tax on the sale price.

Sales of Vehicles Registered and Titled in Other States

Use tax may be due on new vehicles (other than leased vehicles) in those instances where a vehicle is purchased outside of the state and sales tax is not paid. Many states impose a sales tax on vehicle purchases irrespective of where the vehicle will ultimately be titled

and registered. Most of these states have reciprocal agreements in place with one another to allow for a credit for sales taxes paid in the state of purchase.² If a Michigan resident purchases a vehicle in a state with a sales tax rate lower than Michigan's 6 percent rate, use tax would be due on the difference between the 6 percent use tax and the amount of sales tax paid on the other state. When a vehicle is purchased in a state with no sales tax, the full 6 percent use tax is due.

For sales occurring in Michigan, if the vehicle will be titled in a state with a reciprocity agreement with the state, dealers calculate the amount of Michigan sales tax that would be due if the vehicle were titled in Michigan and the amount of the sales tax due in the state where the vehicle will ultimately be titled. The dealer collects the lower of the two amounts and remits it to the state.

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■ 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.

² For instance, until a few years ago, Indiana exempted from its sales tax, motor vehicles purchased in the state for ultimate delivery and registration and title in another state. Michigan residents who purchased a vehicle in Indiana did not pay Indiana sales tax, but paid Michigan use tax when the vehicle was registered and titled in Michigan. Now, under Indiana Public Act 27 of 2003 (House Bill 1708), Indiana sales tax is imposed on all motor vehicle sales at retail including those registered and titled in another state. Michigan residents who now purchase a vehicle in Indiana pay the Indiana sales tax at the time of purchase, and receive a credit for that tax against the state use tax when the vehicle is registered and titled in Michigan.