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BILL



ANALYSIS

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Senate Bill 198 (Substitute S-2 as reported)
Sponsor: Senator Michelle A. McManus
Committee: Finance

(as passed by the Senate)

Date Completed: 4-28-10

RATIONALE

Michigan's Use Tax Act contains an exemption for property used in industrial processing. The present exemption was enacted in 1999 and has not been substantively changed since that time. Over the years, however, the exemption reportedly has been applied inconsistently to equipment used to unload logs at sawmills, based on whether the logs were moved directly from a truck to a sawmill or, instead, were unloaded, sorted into piles on the ground, and then taken to the mill. The tax exemption generally does not apply to property that is used for receiving and storing materials or natural resources. Therefore, the equipment used to sort logs into piles, where they are considered stored, evidently is not exempt, or is taxable for the portion of time it is used for that purpose. The same tax treatment is said to apply to equipment used to move green lumber from a sawmill either directly to a truck or first to storage and then to a truck. Sawmill owners evidently have been assessed penalties as well as tax when they have purchased equipment, such as a front end loader, that is used at times for nonexempt purposes. To address this tax liability, it has been suggested that the industrial processing exemption be expanded.

CONTENT

The bill would amend the Use Tax Act to extend the industrial processing exemption to front end loaders and other specific types of equipment used at sawmills to unload logs and load lumber.

Under the Act, the use tax does not apply property sold to an industrial processor for use in industrial processing; property sold to any person if the property is intended for ultimate use, and is used, in industrial processing by an industrial processor; property sold to a person who uses it to perform an industrial processing activity on behalf of an industrial processor; or a computer used in operating industrial processing equipment.

The Act describes property that is eligible for the exemption, including machinery, equipment, or materials used within a plant site or between plant sites operated by the same person for movement of tangible personal property in the process of production.

Under the bill, this exempt property would include front end loaders, forklifts, pettibone lifts, skidsters, multipurpose loaders, knuckle-boom log loaders, tractors, and log loaders used to unload logs from trucks at a sawmill site for the purpose of processing at the site and to load lumber onto trucks at a sawmill site for the purpose of transportation from the site.

MCL 205.94o

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

The timber industry in Michigan has been struggling throughout the latest recession,

as construction has declined and the demand for lumber has dropped. Although a slight improvement is beginning to be seen, some sawmill operations have gone out of business and others are barely surviving. The financial burden imposed under the Use Tax Act could be the last straw, especially when penalties are assessed.

Sawmills rely on multiple types of equipment to unload, load, and move raw material around the facilities. Although some trucks are self-loading, sawmills often need to use other machinery, such as front end loaders, to unload logs, sort them by species, and move them from the piles to the mill. Depending on the equipment and what it is used for, it may or may not be taxable. According to testimony on behalf of the Michigan Association of Timbermen (MAC), for example, a front end loader is taxable if it unloads logs from a truck and places them into different piles, but it is not taxable if it is used to take logs from either a pile or a truck and place them in the milling process. The same situation exists when the equipment is used to move green lumber: The front end loader is exempt when it loads a truck with lumber that comes straight from the mill, but not if the lumber is placed in temporary storage before shipment, according to the MAC. This tax liability can be significant, especially for a small operation. If a new loader costs \$200,000 and is used 50% of the time for nonexempt purposes, then \$100,000 is subject to the 6% use tax, resulting in a tax of \$6,000 for one piece of equipment. Evidently, however, there is no standard formula for determining the percentage of time equipment is used for nonexempt purposes.

In 2008, legislation was enacted to address a similar problem with the taxation of equipment used in logging operations. Public Act 555 of 2008 amended the Use Tax Act to exempt property sold to an extractive operator for transporting timber from the point of extraction to a place of temporary storage at the site and loading or transporting timber from storage to a vehicle or other equipment that will remove it from the site. Senate Bill 198 (S-2) would take the exemption to the next stage in the process, when the logs arrive at a sawmill and are unloaded, sorted, and processed, and the green lumber is moved to trucks for shipment.

Response: The scope of the bill is too narrow. Other types of facilities, such as veneer mills, pulp mills, and green energy producers, are involved in processing wood and also should receive an exemption for equipment used during the processing. In addition, there is a concern that limiting the expanded exemption to "sawmills" would lead to the denial of the exemption for facilities that already benefit from the industrial processing exemption.

Opposing Argument

The Act states, "Industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage." The proposed exemption would go beyond the boundaries of this definition, and would set a precedent for exempting property used in activities that are not traditionally considered industrial processing. In addition, the only evidence of inconsistent tax treatment by auditors is anecdotal.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce use tax revenue by less than \$1.0 million annually. This loss in revenue would reduce the General Fund and the School Aid Fund, as two-thirds of use tax revenue is earmarked to the General Fund and the remaining one-third of the revenue is earmarked to the School Aid Fund. The bill would have no direct impact on local units of government.

Fiscal Analyst: Eric Scorsone

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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.