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BILL ANALYSIS

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Senate Bill 89 (as enacted) **PUBLIC ACT 160 of 2013**
Sponsor: Senator Dave Robertson
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 11-19-13

## RATIONALE

The General Sales Tax Act, as a rule, imposes a tax of 6% on the sales price of tangible personal property sold at retail. The sales price is the total amount of consideration, including cash, credit, property, and services, for which the property is sold. The sales price also includes various costs and charges specified in the Act, as well as credit for any trade-in. Until recently, this meant that if a person purchased a new automobile, and traded in a used one, he or she had to pay sales tax on the full price of the new car. This struck many people as unfair, because the sales tax originally was paid on the trade-in vehicle when it was purchased. A number of other states provide for a trade-in allowance when the sales tax is calculated on motor vehicle purchases, imposing the tax on the difference between the value of the trade-in and the price of the vehicle being purchased. It was suggested that Michigan should take a similar approach, and extend it to watercraft and recreational vehicles.

## CONTENT

**The bill amended the General Sales Tax Act to exclude from taxation the value of a trade-in on a new or used motor vehicle or titled watercraft, or a recreational vehicle (RV), subject to a phase-in on the value of a trade-in vehicle or RV between December 15, 2013, and January 1, 2038.**

Specifically, beginning November 15, 2013, the Act's definition of "sales price" does not include credit for the agreed-upon value of a titled watercraft used as part payment of a new or used titled watercraft. Beginning December 15, 2013, subject to the phase-in schedule described below, "sales price" does not include credit for the agreed-upon value of a motor vehicle or RV used as part payment of the purchase price of a new motor vehicle or used motor vehicle or RV. In each case, the agreed-upon value must be separately stated on the invoice, bill of sale, or similar document given to the purchaser.

Beginning December 15, 2013, the agreed-upon value of a motor vehicle or RV used as part payment is limited to $2,000 or the actual agreed-upon value of the vehicle or RV, whichever is lower.

On January 1, 2015, and each subsequent January 1, the dollar limit of the agreed-upon value must be increased by $500 (unless Section 105d of the Social Welfare Act is repealed). On January 1 in the year in which the dollar limit exceeds $14,000, there will no longer be a limit on the agreed-upon value of the motor vehicle or RV used as part payment.

(Section 105d of the Social Welfare Act provides for the expansion of the Medicaid program pursuant to the Federal 2010 Patient Protection and Affordable Care Act; and requires the State to seek a Federal waiver allowing the State's modifications to the Medicaid program that accompany the expansion.)

The bill defines "new motor vehicle" as that term is defined in the Michigan Vehicle Code (a motor vehicle that is not and has not been a demonstrator, executive or manufacturer's vehicle, or leased vehicle, or a used or second-hand vehicle).

"Recreational vehicle" also means that term as defined in the Vehicle Code (a new or used vehicle that has its own motive power or is towed by a motor vehicle, is primarily designed to provide temporary living quarters for recreational, camping, travel, or seasonal use, complies with all applicable Federal requirements, and does not require a special highway movement permit to be operated or towed on a street or highway).

The bill took effect on November 6, 2013.

MCL 205.51

## 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

Like the rest of the country, Michigan is recovering from a severe economic recession, although this State's heavy reliance on the motor vehicle manufacturing industry contributed disproportionately to Michigan's fiscal distress. Chrysler and General Motors were forced to seek bankruptcy protection, and a number of dealerships were closed. Automobile manufacturing continues to play a significant role in the State's economy, however, and the industry is regaining financial stability. In order to help with this comeback, the State should do what it can to boost auto sales. By allowing people to buy a new or used vehicle and avoid paying the sales tax on part of the value of a trade-in, the bill may give consumers the incentive they need to make a purchase. This point-of-sale tax break not only will help financially strapped individuals and families, but also will reduce the cost of doing business for companies that buy vehicles. At the same time, increasing sales will benefit dealers, suppliers, and other businesses—and their workers—that are affected by motor vehicle manufacturing and sales.

The bill also might stimulate sales of RVs and titled watercraft by allowing a trade-in allowance for these items. In addition to giving purchasers a tax break and helping to sustain dealers, the bill could bolster the State's tourism industry, especially with respect to watercraft. Evidently, in order to avoid Michigan's tax, some Michigan residents have purchased, registered, and moored watercraft out of State. (Although they technically are liable for the use tax if they use the watercraft in Michigan, it is questionable whether the tax will ever be collected.) Even if the watercraft is purchased in Michigan, the customer might have it delivered to another state where the tax treatment is more favorable. For example, according to testimony on similar legislation in 2011, a customer from Grosse Pointe traded in a yacht worth $2.0 million on one that cost $3.0 million; the person then had the yacht delivered to Ohio, to operate it out of that state. In these situations, brokers lose or have to split their commission, and marinas, servicepeople, and lakeside communities lose business, especially if they are near the State's border. Reportedly, Michigan was the only Great Lakes state that did not have tax-on-the-difference on watercraft. The bill removes this competitive disadvantage by imposing the sales tax only on the difference between the price of the watercraft being purchased and the value of the one being traded in.

### Opposing Argument

The State cannot afford to lose the sales tax revenue that is generated on sales of autos, RVs, and watercraft. The bill might be well-meaning, but any reduction in tax collections should be accompanied by cuts in the budget to accommodate the loss; alternatively, revenue in the budget that will pay for the loss should be identified.

**Response:** For motor vehicles and RVs, sales-tax-on-the-difference will not be fully implemented before 2038. This long phase-in period will mitigate the impact on the State budget. In addition, the estimated revenue loss does not take into account any economic activity that increased sales might generate.

**Opposing Argument**
The bill creates an incentive to trade in used vehicles at a dealership, rather than sell them to private parties. This could drive up the cost of used vehicles.

**Opposing Argument**
The bill ties increases in the credit allowed for a trade-in to the retention of a law that provides for Medicaid expansion. In other words, if the expansion is repealed, the trade-in credit will not increase. Regardless of the reasons to support or oppose Medicaid expansion, that issue is completely unrelated to sales-tax-on-the-difference.

Legislative Analyst: Suzanne Lowe

## FISCAL IMPACT

Based on estimates from the Department of Treasury, the bill will reduce State sales tax revenue by approximately $22.1 million in FY 2013-14, lowering revenue to the School Aid Fund by $16.2 million, the General Fund by $2.7 million, the Comprehensive Transportation Fund by $1.0 million, and constitutional revenue sharing to local units of government by $2.2 million.

The revenue loss will increase in later years. In FY 2014-15, the first full year the bill will be effective, it will reduce State sales tax revenue by approximately $33.1 million, lowering School Aid Fund revenue by approximately $24.3 million, General Fund revenue by $4.0 million, Comprehensive Transportation Fund revenue by $1.5 million, and revenue to local units of government (through constitutional revenue sharing) by $3.3 million. Excluding the impact of inflation, the revenue loss under the bill will grow roughly $8.0 million per year until 2038, eventually reaching in $134.1 million in FY 2037-38 and lowering School Aid Fund revenue by $98.3 million, General Fund revenue by $16.1 million, Comprehensive Transportation Fund revenue by $6.2 million, and constitutional revenue sharing to cities, villages, and townships by $13.4 million. To the extent that vehicle prices and/or sales increase in later years from current levels, the revenue loss will be larger.

The estimates largely do not assume that changes will occur in the distribution of sales. Because private sales between individuals will not qualify for the exemption, nor will new vehicle leasing, the bill creates an incentive for buyers to purchase from a dealer rather than purchasing from individuals or leasing. The market penetration rates of leasing have been at the highest level in years, and near-record highs. If vehicle purchasing behavior changes and sales between private individuals decrease or leasing rates fall, the revenue loss will be greater than estimated, although much of the additional revenue loss will be under the use tax.

Fiscal Analyst: David Zin