**Senate Fiscal Agency**
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BILL ANALYSIS

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Senate Bill 10 (Substitute S-2 as reported)
Senate Bill 11 (Substitute S-2 as reported)
Sponsor: Senator Dave Hildenbrand (S.B. 10)
Senator Joe Hune (S.B. 11)
Committee: Finance

Date Completed: 4-13-15

## RATIONALE

The General Sales Tax Act and the Use Tax Act impose a tax of 6% on the sales price or purchase price of nonexempt personal property and services. Subject to amendments enacted in 2013, the Acts' definitions of "sales price" and "purchase price" include credit for any trade-in, which means that the sales or use tax is imposed on the full price of the item purchased, rather than on the difference between the value of that item and the one traded-in. This struck many people as unfair, particularly in situations involving car sales, and it was pointed that many other states provide an allowance for a trade-in when the sales tax is calculated on motor vehicle purchases. In response, legislation was enacted in 2013 to exclude from the sales and use tax the value of a trade-in on a motor vehicle, recreational vehicle (RV), or a titled watercraft. In the case of a motor vehicle or RV, however, the tax exclusion is limited to the actual agreed-upon value of the trade-in or a specific dollar amount, whichever is less. As of January 1, 2015, the dollar amount is $2,500 and is scheduled to increase each January 1 by $500 until the amount exceeds $14,000. Because that will not occur until the year 2039, it has been suggested that the phase-in be accelerated.

In addition, under the Acts, these tax-on-the-difference provisions apply only to motor vehicles or RVs purchased from a dealer licensed in Michigan. That means if a Michigan resident purchases a vehicle in another state, he or she must pay tax on the full purchase price, with no exemption for the value of a traded-in vehicle. It has been pointed out that, because this tax treatment differentiates between dealers from other states and in-State dealers, it may be a violation of the Commerce Clause of the United States Constitution.[1] For this reason, it has been suggested that the statute should provide the exemption for purchases from out-of-State dealers.

## CONTENT

**Senate Bills 10 (S-2) and 11 (S-2) would amend the General Sales Tax Act and the Use Tax Act, respectively, to accelerate the schedule that excludes from taxation the value of a motor vehicle or recreational vehicle traded in for a new or used vehicle or RV; beginning on January 1, 2016, the bills would double the annual increase in the maximum dollar amount that may be excluded, and provide for no limit beginning in 2026, rather than 2039. Senate Bill 11 (S-2) also would delete language that limits the provision to vehicles purchased from dealers licensed in Michigan.**

[1] The Commerce Clause, found in Article 1, Section 8 of the U.S. Constitution, gives Congress the power to regulate commerce among the states. In addition to granting Congressional authority, the Commerce Clause is understood to restrict states' power to regulate. The "dormant" Commerce Clause is the implicit prohibition against states' enacting legislation that discriminates against or excessively burdens interstate commerce.

On December 15, 2013, the maximum dollar amount allowed as a credit for a trade-in was $2,000. The amount increased to $2,500 on January 1, 2015, and is scheduled to increase each January 1thereafter by $500 until the year in which the limit exceeds $14,000 (i.e., 2039), when there will be no limit on the value excluded from taxation.

Under the bills, the dollar amount would increase to $5,000 on January 1, 2016. On January 1, 2017, and each subsequent January 1, the amount would be increased by $1,000 until the year in which it exceeded $14,000 (i.e., 2026), when there would be no limit on the agreed-upon value.

Currently, under the Use Tax Act, the motor vehicle or RV must be purchased from a new vehicle dealer or used or secondhand vehicle dealer licensed under Section 248 of the Michigan Vehicle Code. (This section contains licensure requirements for dealers, including a requirement that a dealer have an established place of business in this State.) Senate Bill 11 (S-2) would delete that language. Under both bills, a motor vehicle or RV would have to be purchased from a "dealer" (as defined elsewhere in the Code).

In addition, under Senate Bill 10 (S-2), with respect to motor vehicles, RVs, and titled watercraft, the sales-tax-on-the-difference provisions would not apply to leases or rentals. The bill also would require that a titled watercraft be purchased from a watercraft dealer (as currently required under the Use Tax Act).

MCL 205.51 (S.B. 10)
205.92 (S.B. 11)

## 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

By adopting a tax-on-the-difference approach to vehicle sales, the legislation enacted in 2013 allows people to buy a new or used vehicle and avoid paying the sales or use tax on part of the value of a trade-in. This may give some consumers the incentive they need to make a purchase, and help boost auto sales. Evidently, auto sales were up in 2014 compared to 2013, and auto dealers attribute at least part of the increase to the tax law changes. The tax break not only benefits individuals and families, but also reduces the cost of doing business for companies that buy vehicles. The amount excluded from taxation, however, is relatively small, and tax-on-the-difference will not be fully implemented for another 24 years. By doubling the amount of a trade-in that is not taxed, beginning in 2016, the bills would accelerate the phase-in and make the tax relief more meaningful to purchasers.

### Supporting Argument

Under the General Sales Tax Act, the sales tax is collected by Michigan retailers, including car dealers, when a sale takes place in this State. Under the Use Tax Act, when a Michigan resident buys a vehicle from an out-of-State dealer, he or she is liable for the use tax. Under current law, however, the tax-on-the-difference provisions apply only if a motor vehicle or RV is purchased from a dealer licensed in Michigan, which leads to disparate tax treatment depending on the state where the sale occurs. For example, if a Michigan resident buys a new car from an Ohio dealer and trades in his or her used vehicle, the dealer is required by Ohio law to calculate 1) the tax that would be owed in Ohio at a 6% rate (the same rate that Michigan imposes), with credit for the trade-in (which Ohio would allow), and 2) the amount of tax that would be charged in Michigan, but without a trade-in credit (because Michigan law does not allow the credit for an out-of-State purchase). The customer is charged tax at the lower of the two amounts, and Ohio submits the tax collected to Michigan. Because that amount reflects credit for the trade-in, the customer is required to pay the difference as use tax when he or she licenses the car in Michigan.

The example in the table below illustrates what a customer would pay if a purchase took place in Michigan or in Ohio.

| | Michigan Dealer | Ohio Dealer |
|---|---|---|
| Purchase Price | $25,000 | $25,000 |
| Trade-in Value | $2,500 | $2,500 |
| Taxable Value | $22,500 | $25,000 |
| Tax @ 6% | $1,350 sales tax | $1,350 sales tax plus $150 use tax |

In this scenario, the dealer in Ohio would charge the Michigan buyer $1,350 in sales tax and the buyer would have to pay an additional $150 in use tax upon registering the car in Michigan. If the tax-on-the-difference credit applied to purchases from out-of-State dealers, however, the customer would pay only $1,350 in tax regardless of whether the purchase was in Ohio or Michigan.

This tax treatment not only is unfair to purchasers, but creates a disincentive for Michigan residents to purchase vehicles from out-of-State dealers, which may violate the Commerce Clause of the U.S. Constitution. By extending the tax-on-the difference provisions to purchases from out-of-State dealers, the legislation would avoid this conflict.

**Opposing Argument**

When the tax-on-the-difference legislation was enacted in 2013, some people raised concerns about the loss of revenue that would result. It was pointed out, however, that the long phase-in period would mitigate the negative impact. Now, by proposing to shorten the phase-in period, the bills would accelerate the revenue loss.

**Response:** The tax relief enacted may generate increased economic activity, offsetting the loss of tax revenue. Expanding the tax break could have the same effect.

Legislative Analyst: Ryan M. Bergan

**FISCAL IMPACT**

The bills would reduce State and local unit revenue through FY 2037-38. In FY 2015-16, the bills would reduce State revenue by approximately $22.1 million, including a $16.2 million reduction to School Aid Fund revenue, a $1.0 million reduction in Comprehensive Transportation Fund revenue, and a $2.7 million reduction to General Fund revenue; and would lower local unit revenue by $2.2 million through reduced constitutional revenue sharing payments. Total State and local unit revenue losses would increase to $27.8 million in FY 2016-17 and $33.6 million in FY 2017-18. After FY 2025-26, the revenue losses relative to current law would begin declining, reaching zero in FY 2038-39.

Additionally the definitional changes in the bills also would reduce State revenue by an unknown and likely negligible amount. Any revenue loss would affect General Fund revenue, School Aid Fund revenue, and revenue sharing to local units of government, with the relative impact across the funds depending on the relative magnitude of reduction in sales tax revenue compared to the reduction in use tax revenue.

Vehicles purchased in one state for use in another are generally assessed a sales or use tax when transferred to and registered in the state in which they will be used, if the tax assessed by the state where the vehicle is purchased is less than the tax that would have been assessed on the transaction in the state in which the vehicle will be used. However, if the vehicle purchase involved the trade-in of a used vehicle, current law assesses a tax based on the full purchase price of the vehicle, including the value of the trade-in, if the vehicle was purchased from a dealer not licensed under Michigan statute. The bills would reduce the tax levy in this situation by the allowed portion applicable to the trade-in. As a result, the bills would lower the revenue collected from individuals who use a trade-in to help purchase a vehicle out-of-state and then transfer the purchased vehicle to Michigan.

Fiscal Analyst: David Zin

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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.