Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 94 (Substitute S-1 as reported)
Senate Bill 95 (Substitute S-1 as reported)
Sponsor: Senator Dave Hildenbrand (S.B. 94)
Senator Dave Robertson (S.B. 95)
Committee: Finance

Date Completed: 3-23-17

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 taxes the value of a trade-in on a motor vehicle, recreational vehicle (RV), or a titled watercraft if the agreed-upon value is separately stated on the invoice, bill of sale, or similar document given to the purchaser. These tax exclusions do not apply to leases or rentals.

In the case of a motor vehicle or RV, the tax exclusion is limited to the actual agreed-upon value of the trade-in or a specific dollar amount, whichever is less. Beginning December 15, 2013, the dollar amount was $2,000. The amount increased to $2,500 on January 1, 2015, and to $3,000 on January 1, 2016, 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.

CONTENT

Senate Bills 94 (S-1) and 95 (S-1) would amend the General Sales Tax Act and the Use Tax Act, respectively, to increase the dollar amount that is excluded from taxation when a motor vehicle or recreational vehicle is traded in for a new or used vehicle or recreational vehicle.

As noted above, the credit allowed under each Act is a set dollar amount or the agreed-upon value of the trade-in, whichever is less, and must increase each January 1 by $500 until the year in which the amount exceeds $14,000, when there will be no limit on the value excluded from taxation.

Under the bills, the $500 annual increase would apply through 2018. On January 1, 2019, the set dollar amount would be increased to $5,000. Beginning January 1, 2020, and each January 1 thereafter, the amount would increase by an additional $1,000.

Beginning on January 1 in the year in which the amount exceeded $14,000 (i.e., 2029), and each January 1 thereafter, there would be no limit on the agreed-upon value of the motor vehicle or RV used as part payment.

MCL 205.51 (S.B. 94)
205.92 (S.B. 95)

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 22 years. By further increasing the amount of a trade-in that is not taxed, the bills would accelerate the phase-in and make the tax relief more meaningful to purchasers.

Opposing Argument

The bills would have a negative impact on the School Aid Fund, because sales tax revenue directly affects the Fund, and would not account for the deficit. There has been an ongoing pattern of enacting legislation that erodes revenue streams to the Fund. While many bills may have seemingly little impact on the Fund individually, the bills that negatively affect the Fund are costly in the aggregate. Senate Bills 94 (S-1) and 95 (S-1) would continue this trend and limit future resources for Michigan students.

Moreover, 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 lessen the negative impact; the first year of the phase-in was estimated to cost $16.0 million. Now, by proposing to shorten the phase-in period, the bills would accelerate the revenue loss. The bills should retain the original compromise that was made in 2013 by keeping the current phase-in schedule.

Response: Sales tax is not the only source of revenue for the School Aid Fund. Furthermore, the tax relief enacted may generate increased economic activity, offsetting the loss of tax revenue. Expanding the tax break could have the same effect. In addition, the Fund is expected to grow by several percentage points over the next few years. If necessary, future Michigan Legislatures could appropriate more money to the Fund.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bills would reduce revenue to the State General Fund, State School Aid Fund, Michigan Transportation Fund, and constitutional revenue sharing to local units of government; the size of the reduction would increase each year through fiscal year (FY) 2027-28, and then decrease each year until FY 2037-38. The actual impact on each fund affected would depend on the relative impact of the exemption between sales taxes and use taxes, although it is expected that the majority of the impact from the bills would affect sales tax revenue.

Under current law, the portion of the price of a new vehicle exempted as a result of a trade-in is scheduled to increase by $500 per year from a maximum level of $2,000 in 2014 until the maximum exemption reaches $14,000 in FY 2037-38, after which the entire value of a trade-in will be eligible for an exemption. Beginning in 2019, the bills would increase the $500 increment to $1,000, effectively accelerating the impact. As a result, the $14,000 limit would be reached by FY 2027-28. After FY 2027-28, the difference between the exemption under current law and the

exemption created by the bills would decrease, such that by FY 2037-38, the bills would have no fiscal impact.

Based on the estimates when original legislation was enacted, the bills would reduce sales and use tax revenue by approximately $8.4 million in FY 2018-19, $17.7 million in FY 2019-20, and $28.7 million in FY 2020-21. As indicated above, the revenue reduction compared to current law would increase through FY 2027-28. If all of the impact lowered sales tax revenue, the bills would reduce General Fund revenue by approximately $1.1 million in FY 2018-19, $2.4 million in FY 2019-20, and $3.8 million in FY 2020-21; School Aid Fund revenue by approximately $6.1 million in FY 2018-19, $13.0 million in FY 2019-20, and $21.0 million in FY 2020-21; Michigan Transportation Fund revenue by approximately $300,000 in FY 2018-19, $600,000 in FY 2019-20, and $1.0 million in FY 2020-21; and constitutional revenue sharing to local units of government by approximately $800,000 in FY 2018-19, $1.8 million in FY 2019-20, and $2.9 million in FY 2020-21. To the extent that the bills reduced use tax revenue, two-thirds of any reduction would lower General Fund revenue and the remaining one-third would lower School Aid Fund revenue.

The actual impact would be affected by leasing rates and the number of transactions involving a trade-in. To the extent that leasing is higher or the number of transactions involving a trade-in is less than when the original estimates were made, the impact of the bills would be less. For example, using data from 2016, the bills would reduce combined sales and use tax revenue by $2.5 million in FY 2018-19, $5.4 million in FY 2019-20, and $7.9 million in FY 2020-21.

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.