



Senate Fiscal Agency
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BILL



ANALYSIS

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Senate Bills 94 and 95 (as enacted)
Sponsor: Senator Dave Hildenbrand (S.B. 94)
Senator Dave Robertson (S.B. 95)
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACTS 2 & 1 of 2018

Date Completed: 1-19-18

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. Many people considered this unfair, particularly in situations involving car sales. It was pointed out that many other states provide an allowance for a trade-in when the sales tax is calculated on motor vehicle purchases, an approach commonly called "tax-on-the-difference". In response, legislation was enacted in 2013 to exclude from Michigan's sales and use taxes the value of a trade-in on a motor vehicle, recreational vehicle (RV), or a titled watercraft, subject to a phase-in schedule for motor vehicles and RVs, described below. These tax exclusions do not apply to leases or rentals.

In the case of a motor vehicle, 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 was scheduled to increase each January 1 by \$500 until the amount exceeded \$14,000. Based on this schedule, the amount increased to \$4,000 on January 1, 2018. The same phase-in schedule applied to RVs, as well. Because tax-on-the-difference would not have been fully implemented until the year 2039, it was suggested that the phase-in be accelerated for motor vehicles, and that the entire value of an RV trade-in be exempt from the sales or use tax.

CONTENT

Senate Bills 94 and 95 amended 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 is traded in for a new or used vehicle, and eliminate the phase-in schedule for recreational vehicles.

As discussed above, the credit previously allowed under each Act for both motor vehicles and RVs was a set dollar amount or the agreed-upon value of the trade-in, whichever was less, and the dollar amount was scheduled to increase by \$500 each January 1 until the year in which the amount exceeded \$14,000, when there would have been no limit on the value excluded from taxation.

The bills retain this approach for motor vehicles, but increase the set dollar amount to \$5,000 on January 1, 2019, and require the amount to increase by an additional \$1,000 beginning January 1, 2020, and each January 1 thereafter. Beginning on January 1 in the year in which the amount exceeds \$14,000 (i.e., 2029), there will be no limit on the agreed-upon value of the motor vehicle used as part payment.

The bills also remove recreational vehicles from the phase-in schedule. The bills exclude from the definitions of "sales price" and "purchase price", beginning January 1, 2018, credit for the agreed-upon value of a recreational vehicle used as part payment of the purchase price of an RV purchased from a dealer. As required for a motor vehicle, the agreed-upon value must be separately stated on the invoice, bill of sale, or similar document given to the purchaser.

The bills took effect on January 18, 2018.

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 attributed 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 currently excluded from taxation, however, is relatively small, and tax-on-the-difference would not have been fully implemented for another 21 years. By further increasing the amount of a trade-in that is not taxed, the bills will accelerate the phase-in and make the tax relief more meaningful to purchasers.

Opposing Argument

The bills will have a negative impact on the School Aid Fund and the General Fund, because sales tax revenue directly benefits the Funds, and the bills do not account for the deficit. There has been an ongoing pattern of enacting legislation that erodes revenue streams to both Funds, and diverts revenue from the General Fund. While many bills may have seemingly little impact individually, the bills that negatively affect the Funds are costly in the aggregate. Senate Bills 94 and 95 continue this trend and limit future resources for Michigan students and other residents.

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 shortening the phase-in period, the bills will accelerate the revenue loss. The original compromise made in 2013 was a fiscally prudent approach.

Response: Sales tax is not the only source of revenue for the School Aid Fund or the General Fund. Furthermore, the tax relief enacted may generate increased economic activity, offsetting the loss of tax revenue. In addition, the Funds are expected to experience combined growth of several percentage points over the next few years.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bills will reduce revenue to the State General Fund, State School Aid Fund, Comprehensive Transportation Fund, and constitutional revenue sharing to local units of government; the size of the reduction will 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 will 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 will affect sales tax revenue.

Previously, the portion of the price of a new vehicle exempted as a result of a trade-in was scheduled to increase by \$500 per year from a maximum level of \$2,000 in 2014 until the maximum exemption reached \$14,000 in FY 2037-38, after which the entire value of a trade-in would have been eligible for an exemption. Beginning in 2019, the bills will increase the \$500 increment to \$1,000, effectively accelerating the impact. As a result, the \$14,000 limit will be reached by FY 2027-28. (For recreational vehicles no limit applies after December 31, 2017.) After FY 2027-28, the difference between the exemption under previous law and the exemption under the bills will decrease, such that by FY 2037-38, the bills will have no fiscal impact.

Based on data when the original legislation was enacted in 2013, the bills will 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 previous law will increase through FY 2027-28. If all of the impact lowers sales tax revenue, the bills will 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 \$6.3 million in FY 2018-19, \$13.2 million in FY 2019-20, and \$21.2 million in FY 2020-21; Comprehensive 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 reduce use tax revenue, two-thirds of any reduction will lower General Fund revenue and the remaining one-third will lower School Aid Fund revenue.

The actual impact will 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 will be less. For example, using data from 2016 rather than the data available when the 2013 legislation was enacted, the bills will reduce combined sales and use tax revenue by \$2.7 million in FY 2018-19, \$5.6 million in FY 2019-20, and \$8.1 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.