Michigan's Sales Tax and Transportation Investment

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This analysis provides information about Michigan's sales tax to help assess options for increasing transportation investment.

Background

- In November of 2008, The Transportation Funding Task Force, created by Public Act 221 of 2007, submitted its report to the Michigan legislature and recommended that Michigan at least double its current investment in transportation, which represents an annual increase of \$3 billion. The Michigan Infrastructure & Transportation Association (MITA) has often stated that half of this new investment—\$1.5 billion—should come from state sources, with the other half coming from federal and local funding sources.
- MITA supported three bills in the most recent (2008–2010) legislative session which would have raised \$1.1 billion when fully implemented over a period of years:
    - A three-year phase-in of an 8 cent increase in the state gas tax that would have raised it from the current 19 cents/gal to 27 cents/gal. This would have raised approximately \$350.4 million when fully implemented in 2013.
    - Diesel parity to 27 cents/gal (current tax rate is 15 cents/gal), which would have raised \$92.4 million when fully implemented in January of 2013.
    - An increase in vehicle registration fees over five years, which would have raised \$687.4 million when fully implemented.

These three proposals represented the historical and traditional "user fee" approach to transportation funding.

Michigan's 6 Percent Sales Tax—Constitutional Provisions

1. Michigan's 6 percent sales tax actually has two components—a 4 percent tax that has existed for many years, and a 2 percent tax that was adopted as a part of the constitutional school finance reform (Proposal A) in March of 1994. Constitutional restrictions on these two components of Michigan's sales tax differ significantly.

2. ***The constitution does not require that the first 4 percent be levied.*** Article IX, Section 8 says that the Legislature "...shall not impose a sales tax on retailers at a rate of more than 4%..." In other words, the state constitution does not **require** a 4 percent sales tax—rather, it authorizes the legislature to establish such a tax and it limits the maximum rate. ***The legislature has the power to reduce the 4 percent tax rate or eliminate it altogether.***

3. The constitution ***does*** require that the "Proposal A 2 percent" be levied. Article IX, Section 8 states, "Beginning May 1, 1994, the sales tax <u>shall</u> be imposed on retailers at an additional rate of 2%." The entire amount—100 percent—is constitutionally dedicated to the School Aid Fund. This earmarking was designed to replace the revenue lost by local schools when property taxes were reduced by Proposal A.

4. ***The legislature has the authority to exempt items from both the 4 percent and the 2 percent taxes.*** Food and prescription drugs, meals provided to employees, investment coins, periodicals and newspapers, and textbooks sold to K–12 students are examples of

the many exempt items. Some goods are exempt only from the 2 percent tax—electricity, natural gas, and other heating fuel for residential use. The only ***constitutionally*** exempt goods are food and prescription drugs.

5. The 2 percent tax raised $1.9 billion in FY 2009, all of which is constitutionally dedicated to the School Aid Fund (SAF). The 4 percent tax raised $4.2 billion in FY 2009, of which 75 percent ($3.1 billion) is constitutionally dedicated—60 percent to the SAF and 15 percent to revenue sharing.

Statutory Earmarking of the Sales Tax—A Complete Picture

The constitution dedicates 75 percent of the 4 percent tax (60 percent to the SAF and 15 percent to revenue sharing), so one might assume that 25 percent —approximate $1 billion—is available for other purposes. Three statutory provisions, however, dedicate some of this remaining 25 percent:

1. **Revenue sharing.** In addition to the 15 percent constitutional earmarking, The General Sales Tax Act allocates another 21.3 percent of the 4 percent sales tax to revenue sharing. This statutory revenue sharing is subject to annual appropriation decisions by the legislature, however, and the amount actually disbursed can be—and often has been—reduced below this 21.3 percent. The amount actually appropriated in FY2009 was $410 million.

2. **Comprehensive Transportation Fund (CTF).** The CTF is a fund established by state law restricted to supporting public transportation purposes—primarily capital and operating assistance to the state's 79 local public transit agencies. A portion of the 4 percent sales tax that is collected on the sale of motor vehicles, fuel used to propel motor vehicles, and parts and accessories of motor vehicles ("auto-related sales") is allocated by the General Sales Act to the CTF. Like statutory revenue sharing, this can be changed each year by the legislature. The amount appropriated in FY2009 was $83 million.

   Note: None of the money from the CTF goes to roads and bridges.

3. **Health Initiative Fund.** The General Sales Tax Act also earmarks the 4 percent sales tax collected on the sale of computer software to the Michigan Health Initiative Fund, but with the stipulation that it be not less than $9 million or more than $12 million. [MCL 205.75(5)]. The amount appropriated in FY2009 was $9 million.

4. What's Left? After statutory deductions for revenue sharing, the CTF, and the Health Initiative Fund, the state's General Fund received $533 million of the $4,162 million generated by the 4 percent sales tax in FY 2009.

Sales Tax Distribution Summary (FY 2009):

- 4 percent: **$4,162 million**
  - $2,497 million—SAF (constitution)
  - $630 million—local government (constitution)
  - $410 million—local government (statutory)
  - $83 million—CTF (statutory)
  - $9 million—Health Initiative Fund (statutory)
  - $533 million—General Fund
- 2 percent: **$1,900 million**—SAF (constitution)
- Total 6 percent Sales Tax Collected (FY 2009): **$6,062 million**

Sales Tax on Auto-Related Purchases

Some have suggested that the sales tax on auto-related purchases be considered as a possible source for additional transportation funding. Following is a breakdown of that revenue:

Auto-related sales tax collections from both the 4 percent and the 2 percent sales tax totaled $1,773.7 million in FY 2010. This is a significant portion of all sales tax collections in Michigan—29 percent—and is composed of the following segments:

- $849.7 million—New Car Dealers
- $831.0 million—Gasoline Service Stations[1]
- $89.9 million—Automotive Accessory Dealers
- $3.1 million—Used Car Dealers Only
- **$1,773.7 million** total

The breakdown between the 4 percent and the 2 percent taxes collected from auto-related purchases is as follows:

- 4 percent: **$1,182.5 million** (This $1,182.5 million is constitutionally and statutorily dedicated in the same way as are other collections from the 4 percent tax)[2]:
  - $790.5 million (60 percent)—SAF (constitutional)
  - $177.4 million (15 percent)—Revenue Sharing (constitutional)
  - $76.8 million—CTF (statutory)
  - $137.8 million—General Fund

- 2 Percent: **$591.2 million** (This entire amount is constitutionally dedicated to the SAF in the same way as are all collections from the 2 percent tax.)

A Solution to Transportation Investment Challenge: Sales Tax on Gasoline

Michigan is one of only six states that assess their sales tax on gasoline purchases. Assuming an average price of $2.50 for 2009, sales taxes on motor fuels totaled $718.2 million in FY 2008-09.

Not one penny of this sales tax revenue goes to roads and bridges. This might be surprising to many people in Michigan who simply assume that all taxes paid at the pump are taxes that are used for roads and bridges. The distribution of the sales tax collected on gasoline purchases, however, is subject to the same constitutional and statutory provisions and earmarking as all sales tax revenue outlined above—in other words, the vast majority is constitutionally dedicated to the School Aid Fund (SAF) and revenue sharing payments to local units of government. Of the estimated $718.2 million raised by the sales tax on motor fuels in FY 2008-09, $526.7 million went to the SAF and $71.8 million went to revenue sharing.

The power of the legislature to exempt items from both the 4 percent and the 2 percent tax, however, provides a potential solution for more transportation investment: the legislature could

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[1] Retailers in Michigan do not report sales tax collections by product, so this is the amount collected by business code "Gasoline Service Stations." Some of the sales at gas stations are not auto-related, but the current process for determining auto-related sales has been in place for many years. Estimated sales tax collections from fuel purchases can be estimated by using gas tax collections and average prices.

[2] The Health Initiative Fund, mentioned earlier, does not receive revenue from the sales tax on auto-related purchases.

exempt gasoline purchases from the sales tax and increase the gas tax to raise an equivalent amount of revenue—about 15 cents per gallon[3].

This proposal could be enacted by the legislature without amending the state constitution. Severe political challenges, however, do exist. Both local public schools and units of government would lose revenue, and they would vehemently oppose the proposal unless a way of making them financially whole could be devised.

But this proposal has several advantages: (1) It would ensure that ***all*** taxes paid at the pump go to transportation purposes—which many people in Michigan believe is currently the case, even though it is not. (2) Motorists would not experience a tax increase with this proposal, because it simply shifts the taxes they currently pay for gasoline from the sales to the gas tax. In fact, as gas prices increase, shifting from a percentage tax (the current sales tax) to the per gallon gas tax actually results in a net tax decrease over time.[4] (3) Another advantage of this proposal is that it does not depart from the user pay principle that has been the heart and soul of transportation funding historically.

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[3] Based on the estimate that each penny of the gas tax raises $43.8 million

[4] For example: Assuming an average price of $2.50 per gallon, the 6% sales tax raises 15 cents for every gallon purchased. If gas prices were to increase to $3.00 per gallon, however, the 6% sales tax now raises 18 cents for every gallon purchased. In contrast, a per gallon gas tax of 15 cents would remain at 15 cents.