



Senate Fiscal Agency
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BILL ANALYSIS



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Senate Bills 906 and 907 (as reported without amendment)
Sponsor: Senator Jack Brandenburg
Committee: Finance

Date Completed: 3-29-18

RATIONALE

The General Sales Tax Act and the Use Tax Act impose a tax of 6% on the purchase price or sales price of nonexempt personal property and services. The Acts exempt from taxation certain items, property, and vehicles, including property or services sold to a school if the school is not operated for profit and meets other criteria. In addition, a transaction in which a business leases a school bus to a school district is considered exempt from the taxes levied under the Acts. However, if the lease of a bus also includes the services of a driver, the transaction is subject to taxation, which means that the company leasing the bus to the school must pay tax at the time of acquiring the bus.

The situation described above involves a mixture of a nontaxable service and taxable personal property. This type of transaction was addressed by the Michigan Department of Treasury in Revenue Administrative Bulletin 2015-25. According to the Bulletin, the tax treatment depends on whether the property is incidental to the service, based on a test adopted by the Michigan Supreme Court (as discussed in **BACKGROUND**, below). If the transaction is for a service, then the personal property used to complete the service is considered incidental and is not tax-exempt.

Some people believe that this distinction is unfair in the context of a lease between a school district and a private company for buses and pupil transportation services. Evidently, this type of arrangement can be more cost-efficient to schools than purchasing buses and hiring drivers would be. There are concerns that requiring private companies to pay the sales or use tax on buses used in these situations will increase their costs of doing business, and those costs may be passed on to the school districts. Thus, it has been suggested that both a bus and a bus service provided to a school district through a leasing agreement should be tax-exempt under State law.

CONTENT

Senate Bills 906 and 907 would amend the General Sales Tax Act and the Use Tax Act, respectively, to exempt from taxation under those Acts the purchase, sale, or lease of a school bus or services, including parts, if the school bus or services were used to transport pupils to or from a school or school-related events.

Specifically, under the bills, the sale, purchase, or lease of a school bus or services, and parts affixed to or to be affixed to a school bus that were used in the repair or maintenance of a school bus, would be exempt from taxation under the Acts if the school bus or services were used in the performance of a contract entered into with an authorized representative of a school for the transportation of preprimary, primary, or secondary school pupils to or from a school or school-related events authorized by the administration of the school.

Under each bill, "lease" would mean any transfer of possession or control for a fixed or indeterminate term for consideration and could include future options to purchase or extend.

"School" would mean a public school or public school academy as defined in the Revised School Code. "School bus" would mean the term as defined in the Pupil Transportation Act.

(That Act defines "school bus" as a motor vehicle with a manufacturer's rated seating capacity of 11 or more passengers, including the driver, used for the transportation of preprimary, primary, or secondary school pupils to or from school or school-related events or a multifunction school activity bus manufactured after September 2, 2003, as defined in Federal law. "School bus" does not include a vehicle operated by a public transit agency or authority.)

MCL 205.54a (S.B. 906)
205.94 (S.B. 907)

BACKGROUND

According to Revenue Administrative Bulletin 2015-25, sales or use tax is due on the sales or purchase price of tangible personal property at the time a lessor acquires the property unless the lessor elects to pay use tax on the rental receipts and meets the criteria to do so. If the lessor makes that election, the property is exempt from sales and use tax at the time it is acquired, and the lessor must pay the use tax on the total rental receipts. Generally, if the lessee of the property is an entity that is exempt from taxation under the Use Tax Act or the property itself is exempt from the tax, then the lessor is not liable for use tax on the rental receipts.

If a transaction involves both a nontaxable service and leased personal property, however, and the transaction is considered to be for a service, then it does not constitute a lease of personal property and the lessor cannot make the election to pay tax on the rental receipts (or avoid taxation if the property is leased to a tax-exempt entity). "Any tangible personal property used in the completion of service is merely incidental to the service", according to the Bulletin. The "incidental to service" test was adopted by the Michigan Supreme Court in *Catalina Marketing Sales Corp. v Michigan Department of Treasury*, 470 Mich 13 (2004), "for categorizing a business relationship that involves both the provision of services and the transfer of tangible personal property as either a service or a tangible property transaction". The test examines the following six factors:

- What the buyer sought as the objective of the transaction.
- What the seller or service provider is in the business of doing.
- Whether the goods were provided as a retail enterprise with a profit-making motive.
- Whether the tangible goods were available for sale without the service.
- The extent to which the intangible services have contributed to the value of the physical item transferred.
- Any other factors relevant to the particular transaction.

In addition, the Act specifies that "lease or rental" does not include the provision of tangible personal property along with an operator for a fixed or indeterminate period of time, where that operator is necessary for the equipment to perform as designed. To be necessary, an operator must do more than maintain, inspect, or set up the tangible personal property.

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

The bills would clarify that a bus or bus service, including parts or equipment, provided to a school through a lease agreement would be exempt from the taxes levied under the General Sales Tax Act and the Use Tax Act. Many school districts lease buses or bus services from companies that have experience and expertise in pupil transportation. These companies can save school districts money by purchasing and maintaining many buses at once. This can be less costly to school

districts than purchasing buses individually and having to maintain previously purchased buses. For example, a representative of one company testified during a Senate Finance Committee meeting that it saved a school district in Grand Rapids about \$19.5 million through its services. The money a school district may save from an agreement with a bus or bus service leasing company can be spent to enhance the education of students.

However, a transaction that includes leasing both a bus and a bus operator is considered a service (making the acquisition of the bus taxable) rather than a lease of personal property (which would be tax-exempt in this situation). It is not fair that a transaction involving the lease of only a school bus to a school district is not taxable while a similar transaction that also includes a company bus driver is taxable. Companies that offer agreements that include bus operators could charge schools more to cover the associated taxes, which would limit the money school districts could save through the employment of such services.

By clarifying that transactions involving a bus or bus service leasing agreement with a school would be exempt from the taxes levied under the Acts, the bills would allow schools to maximize savings and preserve resources.

Response: There are other transactions between exempt and nonexempt entities that result in taxes being paid by the nonexempt entity. Creating an exemption for a specific transaction would not be fair.

Opposing Argument

The bills would erode the distinction between activities performed entirely by a tax-exempt entity and activities performed on behalf of that entity, and would result in the loss of money that otherwise would go to the School Aid Fund for schools.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bills would reduce sales and use tax revenue by approximately \$3.8 million or more per year. Based on data from the 2012 Economic Census, approximately 263 small buses and 591 large buses were purchased for school transportation in Michigan that year. Prices for buses vary by bus size and options, but diesel buses can range from \$60,000 to \$100,000 per bus while an electric bus can cost between \$225,000 and \$300,000. Assuming an average price of \$75,000, sales and use tax on those vehicles would total approximately \$3.8 million. The impact on the General Fund and the School Aid Fund would depend on the relative distribution of transactions between the sales tax and the use tax. Under the sales tax, 73.3% of revenue is distributed to the School Aid Fund, 10% is distributed to constitutional revenue sharing to local units of government, approximately 4.6% goes to the Michigan Transportation Fund, and the remainder is directed to the General Fund. Under the use tax, one-third of the revenue is directed to the School Aid Fund, with the remainder directed to the General Fund.

Fiscal Analyst: David Zin

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