

Senate Fiscal Agency
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SFA



BILL ANALYSIS

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House Bill 5212 (Substitute S-1 as reported)
House Bill 5213 (Substitute S-1 as reported)
Sponsor: Representative Kirk A. Profit
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 6-19-98

RATIONALE

Currently, under the General Sales Tax Act and the Use Tax Act, the laundering of textiles (clothing, uniforms, tablecloths, towels, etc.) is considered a service and as such is not taxed. In addition, property sold to an industrial processor for use or consumption in industrial processing is exempt from the taxes, if the industrial processor transforms or modifies the property for ultimate sale at retail. Since the materials laundered or cleaned by a launderer are not generally sold to the customer, however, because the customer already owns the materials or is renting them from the launderer, the launderer does not qualify for the industrial processor tax exemption. As a result, the taxes do apply to textiles purchased by a launderer for its customers' use, and the materials used to clean the launderer's or customers' textiles. It has been argued that this situation places Michigan laundering firms at a competitive disadvantage to similar businesses in Ohio and Indiana.

Reportedly, in Ohio and Indiana sales of textiles and supplies to laundering firms are tax exempt, but the laundering of the textiles is taxable. When these firms have a contract with a Michigan business for laundering, however, the laundering is not taxable because, as noted above, in Michigan the laundering is considered a service and not a sale. Thus, an Ohio or Indiana firm can complete the transaction without tax. At the same time, a Michigan launderer must pay the 6% sales tax on textiles and supplies it purchases in Michigan, or the 6% use tax if textiles and supplies purchased out-of-State but used in Michigan. It has been suggested that the Acts be amended to adjust the State's tax treatment of launderers to mirror that of Ohio and Indiana, by exempting sales of textiles and cleaning supplies to laundry operations and instead taxing the laundering.

CONTENT

House Bill 5212 (S-1) would amend the General Sales Tax Act, and House Bill 5213 (S-1) would amend the Use Tax Act, to exempt from the tax sales of tangible personal property to an industrial processor who laundered or cleaned textiles for reuse, sale, or rental under a service or rental agreement with a term of at least five days. Further, under House Bill 5212 (S-1), the sales tax would apply to the laundering or cleaning of textiles under a sale, rental, or service agreement with a term of at least five days.

In addition, under the bills, the sales or use tax would not apply to sales of tangible personal property to a restaurant or other retail sales business, whether or not it was an industrial processor, if the property were a textile that had been laundered or cleaned for reuse, sale, or rental under a service or rental agreement with a term of at least five days.

Under the bills, "textiles" would mean goods that were made of or incorporated woven or nonwoven fabric, including, but not limited to, clothing, shoes, hats, gloves, handkerchiefs, curtains, towels, sheets, pillows, pillow cases, tablecloths, napkins, aprons, linens, floor mops, floor mats, and thread. Textiles also would include materials used to repair or construct textiles, or other goods used in the rental, sale, or cleaning of textiles.

To claim a refund for sales or use taxes, a person who laundered or cleaned textiles would have to file within 90 days after the effective date of the bills.

MCL 205.51 et al. (H.B. 5212)

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

Currently, Michigan commercial laundries that supply clean linens such as tablecloths, sheets, towels, uniforms, aprons, and floor mats to customers, are at a competitive disadvantage to competitors in neighboring states, particularly in southeastern and southwestern Michigan, where there are large markets close to the State border. If they cannot compete, these businesses will suffer and jobs will be lost. An Ohio or Indiana laundry that does business in Michigan neither pays tax when it purchases the textiles it intends to supply to customers nor collects tax when delivering clean laundry to its Michigan customers. At the same time, a Michigan laundry doing business in Ohio or Indiana pays either a sales or use tax on its textiles (depending on whether it purchases them in-State or out-of-State) and must collect the Ohio or Indiana sales tax from its customers in those states. So, a laundry in Ohio or Indiana has a competitive advantage when bidding for business in Michigan. The bills would exempt from taxation sales of textiles and cleaning supplies to laundering firms, but tax the laundering of the textiles. This means that Michigan laundry firms would be subject to the same tax treatment that Ohio and Indiana firms currently enjoy, which would allow commercial laundry operations based in Michigan to compete on an even basis with similar operations in neighboring states.

Supporting Argument

Although House Bill 5212 (S-1) would impose the sales tax on the laundering of textiles under a sale, rental, or service agreement with a term of at least five days, the tax would not apply to such sales (i.e., laundering services) to a restaurant or other retail sales business. This would ensure that the bills did not benefit the commercial laundry industry at the expense of businesses that use their services. Otherwise, these operations would have to pay the sales tax each time they had textiles cleaned by a launderer.

Opposing Argument

Under the Acts, to claim an exemption from taxation under the industrial processor provisions, an industrial processor must transform or modify the property for ultimate sale at retail. Since launderers clean textiles that the customer owns, or clean and rent textiles to customers, there is no retail sale between the launderer and the customer and therefore no exemption. The bills specifically would exempt sales to an "industrial processor" who laundered or cleaned textiles, and would include in the definition of textiles materials used to repair or construct textiles, as well as other goods used in the rental, sale, or cleaning of textiles. This would create a significant exception to current tax practices, and would apply to an unspecified, overly broad array of products, in addition to singling out a specific business for special treatment. This would be improper tax policy and would set an unwelcome precedent for taxing services.

Legislative Analyst: G. Towne

FISCAL IMPACT

It is estimated that House Bills 5212 (S-1) and 5213 (S-1) would reduce sales and use tax revenue by a net \$1.0 million in FY 1998-99 and FY 1999-2000.

This net loss in revenue would affect the School Aid Fund (SAF), revenue sharing, and General Fund/General Purpose (GF/GP) revenue. While actual data are not available on the breakdown between the sales and use tax currently being paid by the launderers, it is assumed that 50% of it is sales tax and 50% is use tax. It is also assumed the new tax that would be paid by nonretail customers of the industrial launderers would be 100% sales tax. Based on these assumptions, the estimated net loss in sales and use tax revenue in FY 1998-99 and FY 1999-2000 would have the following fiscal impacts by budget areas: SAF revenue would increase \$0.4 million, revenue sharing would increase \$0.4 million, and General Fund/General Purpose revenue would decline by \$1.8 million.

Fiscal Analyst: J. Wortley

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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.