

Senate Fiscal Agency
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SFA



BILL ANALYSIS

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Senate Bill 988 (as enrolled)
Senate Bill 989 (as enrolled)
Sponsor: Senator Joanne G. Emmons
Committee: Finance

Date Completed: 9-14-00

RATIONALE

The Customer Choice and Electricity Reliability Act (Public Act 141 of 2000) restructures the electricity industry in Michigan. Among its many provisions, the Act requires the Public Service Commission (PSC) by January 1, 2002, to issue orders establishing the rates, terms, and conditions of service that allow all retail customers of an electric utility or provider to choose an "alternative electric supplier", that is, a person selling electric generation service to retail customers in Michigan; and requires electric utilities to "unbundle" their rate schedules and separately identify charges for discrete services. (Commercial and industrial rates must be unbundled within one year after the effective date of Public Act 141, or by June 5, 2001. After that date, the PSC may order the unbundling of residential rates.) It has been pointed out that the unbundling of charges for electricity services, and the possible retail sale of electricity by out-of-State companies, will affect the State's taxation of electricity.

Presently, the price charged for electricity reflects the costs incurred to generate, transmit, and distribute the electricity, and the sales tax is assessed on this total price. When the electric rates are unbundled as provided in Public Act 141, the generation, transmission, distribution, and other aspects of providing electricity will appear as separate items on customers' bills. Under current sales tax law, an unbundled structure will allow the sales tax to be assessed only on the charge for the generation of electricity, a tangible product, and only on electricity purchased from an in-State company. The sales tax may not presently be assessed on electricity purchased from an out-of-State company, or on the prices charged for the services of transmitting and distributing the electricity. The Use Tax Act (which, in general, taxes products purchased out-of-State but consumed in Michigan) does not address this issue specifically. It has been suggested that the sales tax specifically be applied to the transmission and distribution of electricity, and that the use tax be imposed on electricity and other types of power.

CONTENT

Senate Bill 988 (S-1) would amend the General Sales Tax Act, and Senate Bill 989 (S-1) would amend the Use Tax Act, to specify that, beginning September 20, 1999, the taxes would apply to the transmission and distribution of electricity, whether the electricity was purchased from the delivering utility or from another provider. Further, Senate Bill 989 (S-1) provides that the use tax would apply to electricity, natural or artificial gas, or steam.

Currently, the General Sales Tax Act taxes the sale of electricity, natural or artificial gas, or steam, if the sale is made to the consumer or user for consumption or use rather than for resale. Senate Bill 988 (S-1) would retain this provision, and require that the sale of the transmission and distribution of electricity also be made to the consumer or user of the electricity for consumption or use.

Senate Bill 988 (S-1) is tie-barred to Senate Bill 555. As passed by the House, that bill would amend the General Sales Tax Act to exempt from the tax sales of nonalcoholic beverages in a sealed container, sold from a vending machine or mobile facility.

MCL 205.51 (S.B. 988)
205.92 (S.B. 989)

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 restructuring of electric utilities in Michigan will have consequences for the taxation of electricity as it is currently applied. The General Sales Tax Act applies to retail sales of tangible personal property; however, the tax on sales of electricity (a tangible product) includes transmission and distribution of the product, which are contained in the total price.

Because Public Act 141 of 2000 requires electric utilities to unbundle their charges and separately identify the various services inherent in supplying electricity to a customer, the tax will apply only to the generation of the electricity and not the total charge. Second, although out-of-State electric utilities may sell electricity to persons in Michigan, if an out-of-State utility or provider does not have nexus (a physical presence) in Michigan, the sales tax will not apply. While the use tax is imposed on out-of-State sales of property consumed in Michigan, currently the Use Tax Act does not specify that it applies to the sale, transmission, and distribution of electricity. By applying the sales and use taxes to the generation, transmission, and distribution of electricity, the bills essentially would maintain the current level and method of taxation on electricity. This would prevent a substantial loss of revenue to the State, particularly to the School Aid Fund.

Opposing Argument

Taxes on the sale of electricity are regressive, given that everyone needs electricity and a family with low household income pays a larger percentage of its total income for electricity than is paid by those with greater wealth. The bills would maintain the status quo for ratepayers, meaning that people would continue to pay the taxes they pay now. Without this legislation, the State now has an opportunity to lower taxes for this essential commodity by over \$100 million per year, which will provide substantial tax relief to those who need it.

Response: The bills are needed to prevent erosion of the sales tax, and the resulting effect on the School Aid Fund. In addition, if the bills are not adopted, the sales tax will still apply to generation (though not transmission and distribution) of electricity by in-State providers. This will result in an unfair tax climate in which sales by in-State providers will be taxed but those from out-of-State will not.

Opposing Argument

Currently, under the General Sales Tax Act, the tax applies to sales of electricity, gas, or steam. Senate Bill 988 (S-1) specifies that sales would include the transmission and distribution of electricity, but it is silent regarding the transmission and distribution of gas. This would seem to mean that a customer would be charged sales tax for the transmission and distribution of electricity, although there is no statutory authority to tax the transmission and distribution of gas.

Legislative Analyst: G. Towne

FISCAL IMPACT

Assuming a scenario is in place in FY 2000-01 that includes, 1) unbundled electricity prices (at current levels), 2) the current sales tax law, and 3) the

purchase of all electricity from in-State companies, then sales tax revenue will be reduced an estimated \$131 million, which will reduce School Aid Fund revenue \$87 million, revenue sharing \$40 million, and General Fund/General Purpose revenue \$4 million. Under the provisions in these bills, the sales and use taxes would continue to be assessed on the price of generating, transmitting, and distributing electricity even if electricity prices are unbundled; however, other current components of the price of electricity related to billing and ancillary charges, would not be taxed. Therefore, these bills would reduce the maximum potential loss in sales tax revenue from the sale of electricity from \$131 million, under current law, to an estimated \$20 million. This \$20 million loss in sales tax collections would reduce School Aid Fund revenue \$13.3 million, revenue sharing \$6.0 million, and General Fund/General Purpose revenue \$0.6 million.

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