

Legislative Analysis



USE TAX: CONVERTING PROPERTY FROM EXEMPT TO NON-EXEMPT USE

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House Bill 4882

Sponsor: Rep. Steve Bieda

Committee: Tax Policy

Complete to 8-29-07

A SUMMARY OF HOUSE BILL 4882 AS INTRODUCED 6-7-07

The bill is an amendment to the Use Tax Act. Its stated intent is to clarify that a person who acquires tangible personal property for an exempt use and who subsequently converts that property to a taxable use is liable for the use tax levied under the act.

The Use Tax Act imposes a 6 percent tax on the purchase price for the privilege of using, storing, or consuming tangible personal property or services in the state. However, the use tax does not apply to, among other things, property purchased for resale or for demonstration purposes.

House Bill 4882 would amend the statute (at MCL 205.97) to say a person who acquires tangible personal property or services (that are otherwise taxable) for any tax-exempt use who subsequently converts that property or service to a taxable use, including an interim taxable use, is liable for the tax. If property or services are converted from an exempt use to a non-exempt use, the use tax would be imposed without regard to any subsequent tax-exempt use.

Definition of Use

The act defines "use" to generally mean the exercise of a right or power over tangible personal property incident to the ownership of that property, including transfer of the property in a transaction where possession is given. House Bill 4882 adds that "use" (subject to taxation under the act) includes converting tangible personal property acquired from an exempt use to a non-exempt use.

Definition of Purchase

Under the act "purchase" generally means to acquire for a consideration, whether affected by title transfer, possession, or license to use or consume; whether the transfer is absolute or conditional; and whether consideration is a price or rental in money, or by way of exchange or barter. House Bill 4882 adds that "purchase" includes converting tangible personal property acquired for an exempt use to a non-exempt use.

Definition of Consumer

The act defines "consumer" to generally mean a person who has purchased tangible personal property or services for storage, use, or consumption. House Bill 4882 adds that "consumer" includes a person who has converted tangible personal property acquired for storage, use, or consumption exempt from taxation to storage, use, or consumption that is not exempt.

Effective Date

The bill would be retroactive to and take effect on September 30, 2002, and apply to all tax years that are open under the statute of limitations provided in the Revenue Act.

FISCAL IMPACT:

The Department of Treasury estimates that the *Betten Auto Center* decision (See Background Information) has a potential one-time cost of \$250.2 million based on refund claims received from automobile manufacturers and dealerships, and projected on-going costs of \$29.2 million. To the extent the bill reduces refund claims and subjects converted property and services to taxation, the state would realize cost savings on the order of the above cited figures.

BACKGROUND INFORMATION:

The applicability of the use tax to tangible personal property converted from an exempt use to a non-exempt use has been the subject of considerable litigation in recent years, particularly how the use tax applies to motor vehicles used by auto dealers as "demonstrator" vehicles.¹ Under the General Sales Tax (MCL 205.54d) and the Use Tax Act (MCL 205.94) an automobile dealer is limited to a certain number of vehicles that may be titled to be used as tax-exempt demonstrator vehicles, based on the dealer's volume of new vehicle sales in a calendar year, as shown in the table below:²

New Vehicles Sold in Calendar Year	Tax-Exempt Demo Vehicles Allowed Per Year
0 – 25	2 vehicles
26 – 100	7 vehicles
101 – 500	20 vehicles
501+	25 vehicles (max.)

Public Act 110 of 2002 (SB 678) amended the Use Tax Act [MCL 205.93(2)] to specify that motor vehicles held for demonstration purposes beyond this limitation are subject to a tax of 2.5% of the purchase price plus \$30.00 per month beginning with the month that the dealer uses the car or truck in a nonexempt manner.

¹ Under the Michigan Vehicle Code (MCL 257.11a) a demonstrator vehicle is motor vehicle used by a prospective customer or a motor vehicle dealer or his agent for testing and demonstration purposes.

² See also Chapter 8, Section 8-3 of the Department of State's Dealer Manual (Revised February 2007).

Crown Motors of Charlevoix, Ltd. v. Department of Treasury

At issue in *Crown Motors* was whether the dealership was subject to the use tax on vehicles that were acquired for resale and eventually sold by the dealership, but were used in the interim by the dealership beyond demonstration purposes. In filings with the Michigan Tax Tribunal (MTT Docket No. 273695) and the Court of Appeals (Docket No. 240555, unpublished decision), the Department of Treasury essentially argued that after acquiring used vehicles for resale, Crown Motors "converted" (used) them to their own use prior to reselling the vehicles several months later, with this conversion triggering a use tax liability. Neither the tax tribunal nor the court of appeals sided with the department in this instance.

Betten Auto Center v. Department of Treasury

Following the Michigan Court of Appeals decision in *Crown Motors*, Betten Auto Center (and others) sought refunds from the Department of Treasury for use tax it paid on vehicles the dealership acquired for resale and ultimately sold. In the interim, employees were permitted to use the vehicles, with certain restrictions, including paying \$25 for insurance costs, making the vehicle available for demonstration during business hours, keeping the vehicle clean and ready to be shown to prospective buyers, prohibiting others from driving the vehicle, and driving the vehicle only within the normal selling area of the dealership.

The department denied the request for a refund on the grounds that the *Crown Motors* decision was not precedential and, similar to its contention in *Crown Motors*, asserting that the use of the vehicles by employees converted the vehicles from an exempt status to taxable status under the provisions of MCL 205.97. The department also asserted that vehicles were subject to taxation at a rate of 2.5% plus \$30 per month under MCL 205.93(2), as added by 2002 PA 110 (SB 678).

The court of appeals (Docket Nos. 265976-265978) held that the vehicles purchased by Betten and used by its employees prior to March 27, 2002 (the effective date of 2002 PA 110) and held for resale are exempt from taxation. Those vehicles used by employees on or after March 27, 2002, in excess of the demonstration limit set in MCL 205.94 are subject to taxation at a rate of 2.5% plus \$30 per month.

On May 25, 2007, the Michigan Supreme Court issued an order affirming the decision of the court of appeals exempting the vehicles because they are purchased for resale [MCL 205.94(1)(c)]. The court vacated that portion of the court of appeals decision finding that those vehicles in excess of the limit on the demonstration vehicles are subject to taxation at 2.5% plus \$30 per month.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.