

TAX NOTE: Proposal 2015-1, What's Next?

Alex L. Rosaen

Traci Taylor

On May 5th, 2015 Michigan's voters will decide whether to pass Proposal 2015-1, a complex package of constitutional and statutory changes that would raise almost \$2 billion in tax revenue for transportation, schools, local governments, and the state Earned Income Tax Credit.

This document briefly outlines the issues the legislature will face if the proposal passes, and identifies several potential sources of transportation funds available to legislators seeking to construct an alternative road funding plan should Proposal 2015-1 not pass.

I. "Fixes" Needed if Proposal 1 Passes

Proposal 2015-1 contains several elements that would require action by the legislature if passed.¹

The proposal may change to how the sales tax is dedicated among state funds. The constitutional changes to the sales tax in Proposal 1 may allow some sales tax funds to be used outside the existing formulas earmarking those funds to schools and local governments.²

Michigan taxpayers would no longer be able to deduct registration tax payments from federal taxable income. Internal Revenue Code section 164 allows for deduction "state and local personal property taxes" using a specific definition of "personal property tax" as a tax on "personal property" that is an "ad valorem tax... imposed on an annual basis." The proposal changes the registration tax (removing the "depreciation" feature of the tax that lowers the tax as the vehicle ages) in a way that may trigger the IRS to rule that it is no longer an "ad valorem" tax, and thus no longer eligible for deduction. Approximately 1.2 million Michigan taxpayers (representing approximately 3 million residents) deducted such taxes on their federal income taxes in recent years. See AEG's recent Tax Note on this subject.³

A tax double-whammy for some fuel users. Certain industries will face a particular burden as they pay the higher fuel excise taxes but do not benefit from the sales tax exemption of motor fuels:

- Industrial and construction businesses purchasing fuel for use on a job site, as opposed to on the roads, will face a compliance burden. The proposal's sales tax exemption applies to fuel "used to operate a motor vehicle on the public roads or highways of this state."⁴ Fuel purchased for use on a job site will be subject to both the higher motor fuel excise taxes and the newly-raised sales tax.

1. For more information, see our discussion of these issues in "Summary of Proposal 2015-1," Memo to Mr. Richard Studley from Anderson Economic Group, February 11, 2015, available at http://www.michamber.com/sites/michamber.com/files/MI%20Chamber%20Prop%201%20Memo%2021115_0.pdf

2. See "Summary of Proposal 2015-1" memo cited in Footnote 1.

3. "Tax Note: Likely Effect of Michigan Prop 2015-1 ("Road Tax" Proposal on May 5, 2015 Ballot) on Federal Income Taxes," Patrick Anderson, Anderson Economic Group, February 2015.

4. Language added to Article IX §8 by HJR UU.

- Users of alternative fuels, such as businesses with large CNG vehicle fleets. The proposal would subject alternative fuels to the same excise tax as “an equivalent amount of diesel fuel,” but it would *not* exempt such fuels from sales taxation.
- Boating industries, whose customers will be subject to the new motor fuel excise taxes, but whose fuel purchases will *not* be exempt from existing sales taxation.

II. Alternatives If Proposal 1 Does Not Pass

If the proposal does not pass, the legislature may wish to construct an alternative plan for providing the funds needed to repair the state’s road network. There are several options available to provide some or all of the estimated \$1.2 billion needed.⁵ These include:

Increasing existing motor fuel taxes. Motor fuel taxes account for approximately half of the funds for the State Trunkline Fund used for road maintenance and repair. Our current motor fuel taxes are 19 cents per gallon for gasoline and 15 cents per gallon for diesel fuel. These rates were raised to their current level in 1998. Each 10 cents added to these rates would raise approximately \$500 million.

Establishing a replacement wholesale tax on motor fuels. Several plans discussed in recent years, including Proposal 2015-1, would replace the excise taxes on motor fuel with a new wholesale fuel tax set at a rate that would collect more revenue than the current taxes. One advantage of this type of tax is that, as a percentage of a market price, it automatically accounts for inflation that affects the price of fuel. The main disadvantage is that fluctuations in the price of fuels could affect funding in a way that is unrelated to how much drivers use the roads.⁶

Exempting motor fuels from the sales tax. In order to limit the rise in after-tax fuel prices associated with higher motor fuel taxes, several proposals, including Proposal 2015-1, exempt motor fuels from the state sales tax. This provision saves drivers approximately 10-20 cents per gallon (depending on the price of fuel) and reduces state revenue by \$600 million.

Raising and reforming the vehicle registration tax. The vehicle registration tax currently provides funds for road maintenance and repairs. Several proposals, including Proposal 1 and other plans considered by the legislature, have included raising revenue by increasing and reforming the tax. Reforms could include making it a true *ad valorem* tax on the value of vehicles, which would decrease the burden on owners of many used vehicles.

General fund appropriations. The legislature may appropriate General Fund revenue to any of the transportation funds, and has done so in the past as a stop-gap measure. Redirecting General Fund funds to transportation would likely require freezes and/or cuts to current priorities.

Taxing electric vehicles. One long-term issue facing our transportation budget is the potential for widespread adoption of electric vehicles, including full electric and “plug-in hybrids,” that rely on electricity for part or all of their energy, and therefore pay less in motor fuel taxes than other drivers. Proposal 1 includes an additional registration tax on such vehicles. Legislators have the option of including some additional revenue from electric vehicle taxes in an alternative plan.

5. The established need for approximately \$1.2 billion for road maintenance and repairs goes back at least to the Transportation Funding Task Force, a group of business, labor, government, citizen leaders who examined the need for additional transportation funds in Michigan. See “Transportation Solutions: A Report on Michigan’s Transportation Needs and Funding Alternatives,” Michigan Transportation Task Force, November 10 2008.

6. While Proposal 2015-1 includes such a wholesale tax, this disadvantage mitigated by the inclusion of a price floor and ceiling mechanism, which will limit swings in tax collections.