SFA BILL ANALYSIS

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Senate Bill 397 (as passed by the Senate)
Sponsor: Senator Norman D. Shinkle
Committee: Finance

Date Completed: 8-30-89

RATIONALE

Automobile dealers usually must borrow money to finance the purchase of inventory (to put cars on the lot). In effect, a dealer has paid for a car before it reaches the showroom. Since the late 1970s and early 1980s, manufacturers have often offered to dealers floor plan interest assistance programs to reduce dealers' interest costs, and thus encourage dealers to maintain certain levels of inventory. Floor plan interest assistance programs can have many variations, such as interest-reduction methods that are achieved by the manufacturer's allowing credits against purchases of inventory, or making direct payments to financial institutions on behalf of dealers. In the early 1980s a dispute arose between dealers and the Department of Treasury over what constituted interest expenses under the Single Business Tax (SBT) Act, which requires firms to add to their tax base interest expenses they deduct in arriving at Federal taxable income.

Many dealers did not consider money received or deferred in floor plan interest assistance programs as money spent for interest expenses, and therefore did not include floor plan assistance as part of the tax base. For example, if a dealer paid 18% interest on money borrowed to finance inventory, and the manufacturer's floor plan interest assistance program reduced the dealer's interest expense by 8%, the dealer would claim a deduction on the Federal tax return equal to a 10% interest expense; the dealer then would add that amount to the SBT return but not include the amount that resulted from the 8% interest reduction achieved through the assistance program. The Department objected to this calculation because it determined that the State was losing revenue on the missing 8% in interest expenses: because manufacturers were claiming the amount resulting from the 8% interest reduction assistance program (using the example above) as a business expense on their Federal tax returns, the amount was not included as income in the manufacturers' SBT calculations. The Department concluded, then, that money contributed or deferred by a manufacturer to an assistance program had to be included in a dealer's SBT tax base. The dispute was resolved temporarily in 1985 with the passage of Public Act 80, which provided that for tax years 1979 through 1984 taxable interest expenses did not include payments or credits received by a dealer from a manufacturer in a floor plan interest assistance program. Since this provision expired, both dealers and the Department have resumed their former positions on the issue. It has been suggested that the provision be made a permanent part of the Act.

CONTENT

The bill would amend the Single Business Tax Act to provide that, for the tax year 1979 and thereafter, an auto dealership would not have to include in its tax base payments or credits, made to or on behalf of the dealership by a manufacturer, distributor, or supplier of inventory to defray any part of the taxpayer's "floor plan interest", if the payments were not deducted as an interest expense in determining Federal taxable income. "Floor plan interest" would mean interest paid to any financial organization that financed any part of the taxpayer's purchase of automobile inventory.

MCL 208.9

S.B. 397 (8-30-89)

FISCAL IMPACT

The bill would lead to an indeterminate reduction in Single Business Tax revenues.

ARGUMENTS

Supporting Argument

Currently, treatment of floor plan interest assistance under the SBT is simply not fair to auto dealers. The SBT Act requires a taxpayer to include in its tax base interest it paid, to the extent it deducted the amount on its Federal return. No matter what the interest rate charged for the purchase of inventory, and the program used to reduce that interest rate, a dealer should be required to pay tax only on the actual cost of the interest. Otherwise, a dealer would have to pay tax on interest that he or she didn't really pay, and the true cost of a dealer's interest could not be reflected if the dealer were required to add to the tax base interest eliminated by a floor plan interest assistance program. Dealers experience tremendous inventory costs, particularly when interest rates are high, and often assistance programs are needed to encourage dealers to maintain a certain level of inventory. The bill represents a continuance of a tax policy that worked well earlier this decade and should be allowed to continue as a permanent part of the Act.

Opposing Argument

The SBT places a tax on the value of a product or service at each stage of its development, and interest expenses are considered part of the value and therefore are taxable under the Act. A manufacturer can provide a subsidy to dealers in floor plan interest assistance programs, and deduct this as a business expense on its Federal tax return; the subsidy is not, then, added to the manufacturer's SBT tax base. Dealers are claiming that any interest paid for or deferred by an assistance program should not be considered part of a dealer's interest cost and therefore should not be added to a dealer's tax base. The bill, if passed, would not affect manufacturers, who would thus continue to pay no tax on amounts used for interest assistance programs. The bill would, however, allow dealers to receive the benefit of the interest assistance program but not be taxed on that income used to fund the program; in other words, both the manufacturers and the dealers would receive the benefits of the program but none of the tax consequences. Interest subsidized in a floor plan interest assistance program should show up in some taxpayer's tax base--the transfer of income from a manufacturer to a dealer should not result in a reduction of SBT liability, as proposed by the bill. Dealers, because they receive the benefits of assistance programs, are the logical choice to pay the tax on amounts used to reduce interest costs. Under the bill, nobody would have to pay taxes on the interest cost, and that simply would not be fair to all other taxpayers who must pay interest expenses under the Act.

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