Legislative Analysis

**SALES AND USE TAX EXEMPTIONS FOR
OVER-THE-COUNTER DRUGS WITH PRESCRIPTION**

House Bills 4464 & 4465
Sponsor: Rep. Lisa Posthumus Lyons
Committee: Tax Policy
Complete to 4-21-15

SUMMARY:

House Bills 4464 and 4465 alter the Sales and Use Tax Acts, respectively, to facilitate the implementation of a tax exemption for the sale of over-the-counter drugs for human use dispensed with a prescription.

House Bill 4464 changes the definition of an over-the-counter (OTC) drug in Section 4g of the General Sales Tax Act (MCL 205.54g); House Bill 4465 specifically exempts the sales of OTC drugs with a prescription from taxation under the Use Tax Act.

House Bill 4464 alters the existing language in Section 4g, and exempts from the sales tax both OTC drugs dispensed by prescription and drugs only available legally by prescription. The existing language defines what is a "prescription" and a "prescription drug," but does not define "over-the-counter" drugs. The language in HB 4464 strikes the definitions of "prescription" and "prescription drug," and then defines OTC drugs as "a drug that is labeled in accordance with the format and content requirements required for labeling over-the-counter drugs under 21 CFR 201.66." The requirements referred to are those laid out by the federal Food and Drug Administration.

The new language replaces the previous definition for "prescription drug," and refers instead to drugs for human use that "can only be legally dispensed by prescription" and exempting them from the sales tax. These drugs are exempt from taxation under the state constitution. The language of HB 4464 is consistent with the language of this section of the Sales Tax Act before it was amended by Public Act 211 of 2013.

House Bill 4465 alters Section 4d of the Use Tax Act (MCL 205.94d) to exempt the sales of over-the-counter drugs with a prescription from the use tax. OTC drugs are defined by the same FDA labeling standard as in HB 4464. Without this companion use tax exemption, the sales tax exemption for OTC drugs simply makes the sale subject to the use tax. This has been the case since Public Act 211 of 2013 took effect on March 14, 2014. By adding OTC drugs to the list of use tax exemptions, sales of these drugs to consumers will now be fully exempt from taxation.

FISCAL IMPACT:

As written, the bills would reduce sales tax revenue, primarily affecting the School Aid Fund (SAF), General Fund (GF), and constitutional revenue sharing. The fiscal impact of

this bill is the same as that of PA 211 of 2013 (or House Bill 4831 from the previous legislative session). Using industry market research data on sales of OTC medications that are likely to be prescribed by a doctor, it is estimated that the bills could reduce sales tax revenue by $8.2 million on a full year basis. Under this estimate, the loss to the SAF would be approximately $6 million, the loss to constitutional revenue sharing would be approximately $820,000, and the loss to the GF would be approximately $1.37 million. The actual amount of these losses will depend on the rate at which doctors prescribe OTC drugs and the prices of those medications, both of which are unknown.

It is important to note that there has not been an aggregate loss of revenue since the effective date of Public Act 211. Because the sale of OTC drugs with a prescription was not exempted from the use tax at that time, the Department of Treasury has been collecting a 6% use tax on these transactions. This switch has affected the distribution of the revenue collected on the sales of these drugs, with 2/3 of the amount collected going to the GF and 1/3 going to the SAF.

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