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BILL ANALYSIS

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Senate Bill 1255 (Substitute S-1 as reported)
Sponsor: Senator Michelle A. McManus
Committee: Finance

Date Completed: 10-21-04

RATIONALE

Under the General Sales Tax Act, when an item is sold at auction in Michigan, the 6% tax is levied on the gross proceeds of the sale, even when the auction is held for charitable purposes. Reportedly, people bidding for items at charitable auctions often bid far in excess of their actual value because the extra money is going to a cause they support and the difference between the value of the item and the amount they bid is deductible for Federal income tax purposes. Some people believe that the State should eliminate the sales tax on the proceeds of an auction sale that exceed the market value of the goods sold because the buyer's intent was for the extra money to be a charitable donation.

CONTENT

The bill would amend the General Sales Tax Act to provide that, for the purpose of a charitable auction held by certain not-for-profit taxpayers with a tax-exempt status, "gross proceeds" would mean the fair market value of the auction item. (The tax is levied on people making sales at retail in Michigan at a rate of 6% of their gross proceeds.)

The change would apply to charitable auctions held by taxpayers with tax-exempt status under Section 4q(1)(a) or 4q(1)(b) of the Act. Those sections refer to organizations exempt from the Federal income tax under Sections 501(c)(3) and 501(c)(4) of the Internal Revenue Code; and health, welfare, educational, cultural arts, charitable, or benevolent organizations not operated for profit that were issued an exemption ruling letter (before July 1998) from the Department of Treasury to purchase items exempt from tax. (Under Section 4q(1) of the Act, a person subject to the sales tax may exclude from gross proceeds the sale of personal property to those organizations.)

MCL 205.51

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 bill would address a common occurrence at charitable auctions: people bidding up the price of an item with the idea that the additional proceeds will benefit a charity they support, while the charity then has to remit the 6% sales tax on the entire purchase price, despite the fact that much of the amount paid was intended to be a donation. Often, rather than alienating the buyer by adding the sales tax to the purchase price, as is done in most sales transactions, the charity ends up paying the tax itself. The bill would eliminate the sales tax only on the portion of the sale at auction intended to be a charitable donation, because the tax still would be collected on the fair market value of the purchased item. Charities, however, would be able to retain more of the money intended for them.

Opposing Argument

The bill would provide for the sales tax to be levied only on the "fair market value" of an item sold at auction, yet it does not define the term. There are questions as to whether "fair market value" would be the purchase price for the item at retail, the price a wholesaler would charge, or the cost of the item's component parts. The bill contains no "bright line" rule for taxpayers to follow. During his testimony before the Senate Finance Committee, an official from the Department of Treasury used a recent tax case involving an autographed baseball purchased at a charitable auction to demonstrate how the term "fair market value" can be open to interpretation. He said that the man who purchased the baseball used the fair market value of an unsigned baseball rather than the value of a signed baseball (which the Department contended he should use) when determining its fair market value. The value of a signed baseball would have been significantly higher because most of the item's value came from the signature.

Response: In most cases, the fair market value of an auctioned item is known or can be easily determined.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

The bill would reduce sales tax revenue by an estimated $2.0 million annually. Given the constitutional and statutory earmarking of sales tax revenue, this loss in sales tax revenue would reduce School Aid Fund revenue by $1.4 million and revenue sharing to local units by $0.5 million.

Fiscal Analyst: Jay Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.