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#82

State Sales Tax Rate Increased Effective July 15, 2002

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On July 15, 2002, the state sales and use tax on non-food items increases from 6 percent to 7 percent (as mandated by Section 4 of Chapter No. 856 of the Public Acts of 2002). Since the effective date is almost immediate, cities must act promptly to make sure that city sales subject to the tax—residential and commercial water, for example—are taxed at the proper rate. According to the Department of Revenue, the rate of the state tax to be applied will depend on when the meter is read. If the meter is read before July 15, 2002, the state rate to be applied will be 6 percent. If the meter is read on or after July 15, 2002, the state rate to be applied will be 7 percent.

For July, according to the Department of Revenue, cities will report taxable sales on one line as always. Cities will apply the 6 percent rate for meters read on or before July 14 and the 7 percent rate for meters read on or after July 15.

The act does not affect the 1 percent state rate on water sold to or used by manufacturers (or the corresponding local rates of 1/3 percent if the rate of the local sales tax does not exceed 1 percent and 1/2 percent if the local rate does exceed 1%) nor the 1.5% state rate on gas, electricity, fuel oil, coal, and other energy fuels sold to or used by manufacturers. Neither does the act affect the exemption from state and local sales taxation of electricity, gas, fuel oil, coal, and other energy fuels sold to consumers for residential use, nor the complete exemption of sales of these forms of energy under the local sales tax.

In addition to the 1 percent rate increase in the state sales tax, this new legislation enacts a state tax of 2.75% on the purchase price of items over \$1,600 subject to the local sales tax. This expansion of the local sales tax for state purposes applies to the amount of the purchase over \$1,600 up to and including \$3,200. Local sales taxes remain intact and still apply to the first \$1,600 of the purchase price of a single article. The effect of these changes is that on a non-food purchase, a consumer pays a state sales tax at the 7 percent rate and a local sales tax at the applicable local rate on the first \$1,600 of any purchase, a state sales tax of 9.75% on the part of a purchase over \$1,600 through \$3,200, and then returns to paying a state rate of 7 percent on any amount of a purchase exceeding \$3,200.

Also effective July 15, Section 5 of this act repeals a 1.5 percent (2.5 percent for tobacco products) gross receipts tax on vending machines and applies the state sales tax to vending machine purchases. The increase in revenue from this tax increase is not designated for state

purposes only, so municipalities should get their normal portion of these increased revenues. This part of the act also appears to apply local sales taxes to vending machine sales, since the local sales tax applies to substantially the same items as the state sales tax, and there is nothing exempting vending machine sales from local sales taxes.

Increased revenues produced by increases in the rate of the state sales tax and by the expansion of the local sales tax base for state purposes accrue to the state general fund; municipalities do not share in these revenue increases. Municipalities will continue to receive shared sales tax revenue under the existing formula based upon the sales tax rate in effect before July 15. This means that municipalities should receive substantially the same revenue from this source as last year, taking into account: 1) normal increases when consumers buy more goods and when prices increase, 2) an increase in revenues because of the expansion of the sales tax to include vending machine sales, and 3) leakage that will probably be exacerbated by the increased rate.

This act also provides that the 6 percent state rate plus the applicable local sales tax rate in effect on July 1, 2002, apply to sales to contractors and subcontractors for the performance of lump sum or unit price contracts when the contract was entered into before July 15, 2002 (before September 1, 2002, for subcontracts under a general contract qualifying for the 6 percent rate). The vendor collects the 7 percent tax plus the applicable local rate, and the contractor or subcontractor must apply to the Department of Revenue for a refund of the difference.

Finally, the act does not affect the local sales tax rate on food since the state rate on food is not increased. Local governments retain the authority to levy a maximum local rate of up to 2.75% on most items subject to the state sales tax.

If you have questions about the effects of the increases in sales and use taxes, contact your MTAS Finance Consultant.

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