

Legislative Analysis



SALES AND USE TAX EXEMPTION FOR CLOUD COMPUTING

Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bills 4018 & 4019 as introduced
Sponsor: Rep. Jeff Farrington
Committee: Tax Policy

Analysis available at
<http://www.legislature.mi.gov>

Complete to 2-4-15

SUMMARY:

Currently, prewritten computer software is subject to tax under both the General Sales Tax Act and the Use Tax Act as tangible personal property. The bills would amend the acts in order *to exempt granting the right to use prewritten software installed on another person's server* from sales and use tax. The bills would do this by excluding that activity from the definition of prewritten computer software (and, by extension, from the definition of tangible personal property).

Each of the bills contains an enacting section that says it "is curative and intended to express the original intent of the Legislature concerning the taxation of prewritten computer software."

The term "prewritten computer software" is currently defined in both acts, generally, as "computer software, including prewritten upgrades, that is delivered by any means and that is not designed and developed by the author or other creator to the specifications of a specific purchaser." Both acts specifically include "prewritten computer software" in the definition of "tangible personal property," with the proceeds of the transfer of tangible personal property being subject to taxation under the acts.

House Bill 4018 would amend the General Sales Tax Act (MCL 205.92b). House Bill 4019 would amend the Use Tax Act (MCL 205.51a).

FISCAL IMPACT:

As written, the bills could reduce sales and use tax revenue by an estimated \$43 million to \$49 million dollars for fiscal year 2014-15. This sector of the economy has grown rapidly, and is expected to continue this expansion for the near future. Industry research suggests that the sector could expand by 30% from 2015 to 2020, with forgone sales and use tax revenue rising at roughly the same rate. After 2020, growth in the sector is expected to moderate.

Since the bill is retroactive, it is likely that refunds will be paid out. If the Department of Treasury collected all of the taxes due, this refund amount is estimated to approach \$100 million in FY 15. While the actual amount of total refunds may be less than this, there is

no data available to estimate exactly what that amount will be. The outcomes of ongoing litigation on this issue will affect the final refund amount, but the results of this litigation cannot be known in advance.

The impact of this reduction on individual state funds depends on the mix of sales and use tax liability. For example, if all of the foregone revenue would have been classified as a sales tax liability, approximately 73.3% of the lost revenue would affect the School Aid Fund (SAF), 10% would be a reduction in constitutional revenue sharing, and only about 1.7% of the total reduction would affect the General Fund (GF). Conversely, if all of the foregone revenue would have been classified as use tax, 2/3 of the reduction would affect the SAF and 1/3 would affect the GF. In reality it is likely that there will be a mix of the two. However, there is no data available that would suggest what this mix will be.

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