STATE OF WISCONSIN

REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS

2001 SENATE BILL 55

[Introduced by Joint Committee on Finance by request of Governor Scott McCallum.]

General Nature and Fiscal Effect of Tax Exemption Provisions in 2001 Senate Bill 55

2001 Senate Bill 55 is the 2001-03 Executive Budget Bill ("Bill") proposed by the Governor and introduced by the Joint Committee on Finance at the request of the Governor. The subject of this report is the following seven provisions of the bill that relate to tax exemptions:

1. Taxation of Custom Computer Programs

Under current law, the state sales and use tax is imposed on all sales of tangible personal property, unless specifically exempted, but only on those services specifically identified in the statutes. Generally, prewritten programs--those programs held for general or repeated sale--are considered tangible personal property and are subject to the sales tax. However, custom computer programs are specifically excluded from the definition of tangible personal property under current law, and are thus exempt from the sales and use tax.

SECTION 2244 of the Bill would change the definition of tangible personal property to include custom computer programs and, thereby, subject these programs to the sales and use tax.

The Legislative Fiscal Bureau (LFB) estimates that the fiscal effect of this provision would be a revenue gain of $20.5 million in 2001-02 and $31.0 million in 2002-03. This assumption is based on an effective date of October 1. The Bill provides that the provision takes effect on the first day of the second month after publication of the Bill as an act. The LFB notes that if passage of the budget were delayed, the fiscal estimate in the first year would have to be reduced.

2. Tax Treatment of Certain Types of Tangible Personal Property

Under current law, the sales tax is generally imposed on the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection and maintenance of all items of tangible personal property. The tax is not imposed, however, on the original installation or complete replacement of tangible personal property if the installation or replacement would result in an addition or capital improvement to real property. Additionally, the amount received for labor or services for installing or applying property which, when installed or applied, will constitute an addition or capital improvement of real property is excluded from the definition of sales price so long as the amount is separately stated from the amount charged for the property. Thus, such services are not subject to the sales tax.

SECTION 2245 of the Bill modifies current law by eliminating the exception for installing or applying tangible personal property which, when installed or applied, will constitute an addition or capital improvement of real property. Thus, such property would be subject to the sales tax.

The LFB estimates that this provision would result in a minimal increase in revenues.

3. Public Utility Holding Companies Affiliated With Light, Heat and Power Companies

Generally, under current law, public utility holding companies do not meet the definition of light, heat and power companies, so they are not subject to the state's gross revenue license fee, which is imposed in lieu of general property taxes. Consequently, the property of public utility holding companies is subject to general property taxes.

SECTION 2212 of the Bill provides a property tax exemption for that portion of a public utility holding company's property that is used to provide services to a utility affiliated with the holding company. The LFB estimates that this provision, in conjunction with other provisions of the Bill affecting public utility holding companies, would result in a minimal fiscal effect.

4. Property Tax Assessment of Telephone Companies

Generally, under current law, public utilities are generally subject to state taxation under chapter 76 of the statutes, relating to ad valorem taxes, in lieu of general local property taxation under ch. 70. Under ch. 76, telephone companies are taxed on the basis of property value. Generally, ch. 70 exempts from local taxation the property of telephone companies and certain other companies taxed under ch. 76. However, real and tangible personal property that is used in part for such company's operating purposes and in part for nonoperating purposes is subject to local assessment and taxation at the percentage of full market value that represents the extent of the property's use for nonoperating purposes.

SECTIONS 2114 and 2243 of the Bill would create a new provision under ch. 70 specifying that if real or tangible personal property is used more than 50% in the operation of a telephone company that is subject to tax under ch. 76, then the Department of Revenue (DOR) would assess the property and the property would be exempt from the general property tax. In addition, if real or tangible personal property is used less than 50% in the operation of a telephone company taxed under ch. 76, then the property would be assessed and taxed locally. In addition, ch. 76 of the statutes would be amended to specifically exempt any property that is used less than 50% in the operation of a telephone company from imposition of the ad valorem taxes.

The LFB estimates, based on Department of Administration estimates, that the fiscal effect would be a reduction in general fund tax revenues of $22,500 in 2002-03.

5. Tax Exemption for Air Carriers With Hub Terminal Facilities

Generally, under current law, commercial airlines are exempt from local property taxes and are instead taxed under the state's ad valorem tax under ch. 76 of the statutes. Generally, the property of airlines is valued on a systemwide basis, and a portion of that value is allocated to Wisconsin based on a statutory formula intended to reflect an airline's activity in this state. The resulting value is taxed at the statewide average tax rate for property subject to local property taxes, less state tax credits.

SECTIONS 2110 and 2231 of the Bill provide an exemption from ch. 70 property taxes and from ch. 76 state ad valorem taxes for all property owned by an air carrier company that operates a hub facility in Wisconsin, if the property is used in the operation of the air carrier company, effective with

property assessed as of January 1, 2002. Under the Bill, an air carrier company is defined as a person engaged in the business of transporting persons or property and aircraft for hire on regularly scheduled flights. A hub facility is defined as either: (a) a facility from which an air carrier company operated at least 45 common carrier departing flights each weekday in the prior year from which it transported passengers to at least 15 nonstop destinations or transported cargo to nonstop destinations; or (b) an airport or any combination of airports in Wisconsin from which an air carrier company cumulatively operated at least 20 common carrier departing flights each weekday in the prior year if the air carrier company's headquarters is in the state. The DOR would be required to promulgate an administrative rule defining "nonstop destinations" and "company headquarters" for the purposes of the provision.

The LFB estimates that the transportation fund revenue would be reduced by $1,250,000 in 2001-02 and $2,500,000 in 2002-03 as a result of the ad valorem tax exemption.

6. Property Tax Exemption for Treatment Plant and Pollution Abatement Equipment

Under current law, certain treatment plant and pollution abatement equipment are exempt from the property tax. However, property owners must apply for, and DOR must approve, the property tax exemption for equipment.

SECTION 2104 of the Bill would eliminate the requirement that property owners have to apply to DOR for approval to receive the property tax exemption for treatment plant and pollution abatement equipment. However, the provision would specify that taxpayers subject to state ad valorem taxation administered under ch. 76 (air carriers, conservation and regulation companies, railroad companies, sleeping car companies, pipeline companies and telephone companies) would have to continue to file requests and be subject to DOR approval of a property tax exemption and that the income tax deduction for these taxpayers would remain contingent on DOR approval of the property tax exemption.

7. Property Tax Exemption for Regional Planning Commissions (RPC)

Under current law, RPCs may be created by the Governor, or by a state agency or official that the Governor designates, upon the submission of a petition in the form of a resolution by the governing body of a local unit of government. Generally, the Bill authorizes an RPC, which may conduct research studies, prepare maps, and make plans for physical, social and economic development of the region, to acquire and hold real property for public use. Accordingly, the Bill provides that property owned by an RPC, like property owned by municipalities or by certain other districts, such as school districts, technical college districts and metropolitan sewerage districts, would be exempt from the property tax.

Legality Involved

Generally, there are no questions of legality involved in the provisions of the Bill described in this report. However, with respect to provisions of the Bill relating to an exemption for air carriers with hub terminal facilities in the state, it should be noted that the Legislative Reference Bureau, for a bill drafted for the 1999-01 Legislative Session which provided a similar exemption, noted that the provision raises two constitutional issues. One issue involves the Uniformity Clause of the Wisconsin Constitution and the second issue involves the Commerce Clause of the U.S. Constitution.

Generally under the Uniformity Clause of Article VIII, Section 1 of the Wisconsin Constitution, the taxation of property must be uniform. Although the Legislature is allowed to make exceptions to the uniformity requirement, and to classify property differently, a classification of property for property tax purposes must still be reasonable. [See *Gottlieb v. City of Milwaukee*, 33 Wis. 2d 408 (1966).]

Under Article I, Section 8, Clause 3 of the U.S. Constitution, Congress is granted the power to regulate commerce among the states. The Commerce Clause generally serves as a limitation upon the power of states in the area of interstate commerce. Although the clause is a limit on states' power, it does not eliminate the states' power to tax for the support of their own governments. Challenges to a state tax under the Commerce Clause will be resolved on a case-by-case basis and the results will turn on the unique characteristics of the statute at issue. Because of this case-by-case approach, we are left with little in the way of definite guidelines on how the courts will apply the Commerce Clause to various statutory provisions. However, the U.S. Supreme Court has made clear that a state may not impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local businesses. [See *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).] The court has viewed with particular suspicion state statutes requiring business operations to be performed in the "home" state that could more efficiently be performed elsewhere.

Although it is impossible to predict how a court would rule on either of the above issues should the particular exemption become law and be challenged, it should be noted that a state statute generally enjoys a presumption of constitutionality and that the person challenging the constitutionality of the statute will bear the burden of showing that the statute is unconstitutional.

Public Policy Involved

The provisions of the Bill relating to tax exemptions are good public policy with the exception of the provision relating to the taxation of custom computer programs. That provision should be removed from the Bill. Additionally, the provision of the Bill relating to a property tax exemption for regional planning commissions should be removed from the Bill and considered as separate legislation.