

*STATE OF WISCONSIN**REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**2009 SENATE BILL 62*

[Introduced by Joint Committee on Finance by request of Governor Jim Doyle.]

2009 Senate Bill 62 is the Budget Adjustment Bill ("bill") prepared by the Governor and introduced by the Joint Committee on Finance at the request of the Governor. The bill contains a number of provisions which affect existing statutes or create new statutes relating to the exemption of property or persons from state or local taxes. This report addresses those provisions.

General Nature and Fiscal Effect of Tax Exemption Provisions in 2009 Senate Bill 62

Sales and Use Tax on Digital Goods

Generally, the bill imposes sales and use tax on certain digital products that would be subject to the tax if furnished in tangible form.

The Legislative Fiscal Bureau (LFB) describes current law and the effect of the bill as follows:

With some exceptions, items transferred in electronic form through the Internet are not taxable, even if the item would be taxable if transferred in tangible form (for example, a novel purchased via the Internet in digital format and then printed would not be subject to the tax, whereas the same novel purchased as a paperback book would be subject to the tax).

However, current law makes the following exceptions to this general approach:

- a. Computer software, excluding custom software, is defined by state law to be tangible personal property for purposes of the sales and use tax, without regard to the form in which it is transferred.
- b. Taking photographs, reproducing them in a digital format, and delivering them electronically is a taxable service.
- c. Pay-per-view movies, movie channels, and similar means of viewing motion pictures are cable television services that are specifically subject to tax. However, movies downloaded via the Internet may not meet Wisconsin's current definition of cable television service, which requires amplification of the program.

The provision would impose the 5% sales tax on the sales price from the sale, lease, license, or rental of specified digital goods or additional digital goods at retail for the right to use the specified digital goods or additional

digital goods on a permanent or less than permanent basis and regardless of whether the purchaser is required to make continued payments for such right.

The provision would also impose the 5% use tax on the storage, use, or other consumption of specified digital goods or additional digital goods purchased from any retailer, if the purchaser has the right to use the goods on a permanent or less than permanent basis, and regardless of whether the purchaser is required to make continued payments for such right.

The provision would, however, provide an exemption from the sales and use tax for specified digital goods or additional digital goods, if the sale of and the storage, use, or other consumption of such goods sold in a tangible form is exempt from the tax.

Based on the provisions taking effect October 1, 2009, the Department of Revenue estimates that these provisions would result in increased state sales and use tax revenues of \$4,200,000 in 2009-10 and \$6,700,000 in 2010-11, for a total increase of \$10,900,000 in the 2009-11 biennium.

Sales and Use Tax on Software

The bill modifies the definition of taxable computer software as defined for sales and use tax administration.

According to the LFB:

Under current law, computer programs, except for custom programs, are considered "tangible personal property" and are subject to the state sales tax. Sales of custom computer programs are exempt from the sales tax. The Wisconsin Supreme Court's 2008 decision in *Wisconsin Department of Revenue v. Menasha Corporation* broadened DOR's interpretation of what computer software is considered nontaxable "custom programs." Current administrative rules define "custom programs" as utility and application software designed to accommodate the specific processing needs of the customer. The Department determines whether a computer program is considered a custom program per administrative rules based on all the facts and circumstances, such as (but not limited to) the extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation, whether the program is loaded into the customer's computer by the vendor, and the extent to which the installed program must be tested against the program's specifications.

Further, the LFB states:

The proposal would take effect on the day after publication of the bill and would bring the Wisconsin sales tax code further in line with definitional language used in the Streamlined Sales and Use Tax Agreement. The

Department indicates that the definitional changes would extend sales tax collection to the type of software determined to be exempt in the Wisconsin Supreme Court's Menasha decision. Assuming an effective date of March 1, 2008 [*ed. March 1, 2009*], the proposal would increase state sales tax revenue by an estimated \$9,400,000 in 2008-09 and \$28,300,000 in 2009-10 and annually thereafter.

Streamlined Sales and Use Tax

The bill modifies state sales and use tax laws to conform to the provisions of the multi-state Streamlined Sales and Use Tax Agreement (SSUTA). Generally, the agreement requires states to use uniform definitions in establishing their tax bases. According to the LFB, the modifications to the current sales and use tax base include the following:

- Most types of food sales would be treated the same as under current law. However, some food sales that are now exempt would become taxable and certain sales that are now taxable would become exempt.
- The bill would expand the types of medical equipment that are exempt from tax to include durable medical equipment such as hospital beds, patient lifts, and I.V. stands that are purchased for in-home use.
- The bill would expand the types of mobility enhancing equipment and prosthetic devices exempt from tax, including certain canes, handrails, and grab bars to assist in rising from a commode, tub, or shower; tub and shower stools; ankle braces; and arch supports.
- The bill would eliminate the current exemption for antiembolism elastic hose.
- The current exemptions for equipment used in the treatment of diabetes and equipment used to administer oxygen would be limited to equipment purchased for in-home use.
- The bill would repeal the current exemption for cloth diapers.
- The bill would generally impose the tax on the entire sales price of products comprised of exempt items that are bundled with taxable items by the seller. However, if the retailer can identify, by reasonable and verifiable standards from the retailer's books and records, the portion of the price that is attributable to nontaxable products, that portion of the sales price would not be taxable. Currently, the seller is not required to pay tax on the value of the nontaxable items. Certain exceptions would apply to the general treatment of bundled transactions, such as an exception for transactions in which the value of the taxable products is no greater than 10% of the value of all the bundled products. The bill would also exclude from treatment as bundled transactions certain goods packaged and sold together containing food and food ingredients, drugs, durable medical equipment, mobility enhancing

equipment, prosthetic devices, or medical supplies if the value of the nontaxable items is at least 50% of the value of all of the tangible personal property included (in what would otherwise be a taxable, bundled transaction). In such cases, the entire bundle of goods would be exempt from tax. This treatment is similar to the treatment of certain combinations of nontaxable food, food products, and beverages with taxable items under current law.

- Under the bill, if tangible personal property (such as a construction crane) is provided along with an operator, the transaction would be considered a service (which may or may not be taxable) rather than a lease (which generally is taxable) as long as the operator is necessary for the property to perform in the manner for which it is designed and the operator does more than maintain, inspect, or set up the property. Under current law, the determination of whether such transactions are a lease of property or a service depends upon the amount of control maintained by the operator and the degree of responsibility for completion of the work assumed by the operator.
- Purchases of items (such as telephone directories or candy) that are sold by an out-of-state seller to a Wisconsin purchaser and distributed directly by the seller by common carrier or U.S. mail to Wisconsin locations without the purchaser ever taking possession of the items would become taxable regardless of whether or not the out-of-state seller has nexus with Wisconsin. Under current law, as interpreted by the courts, such sales are not subject to the sales or use tax if the seller is located out-of-state and does not have nexus with Wisconsin.
- The bill would define a “prepaid wireless calling service” as a telecommunications service that provides the right to utilize mobile wireless service as well as other nontelecommunications services, including the download of digital products delivered electronically, content, and ancillary services, and that is paid for prior to use and sold in predetermined dollar units whereby the number of units declines with use in a known amount. Based on this definition, if an otherwise nontaxable nontelecommunications service were purchased through a prepaid wireless calling service and sourced to this state under the sourcing rules, then the service would be subject to the tax imposed on a prepaid wireless calling service.

According to the LFB:

Under these provisions, Wisconsin would conform to the SSUTA effective October 1, 2009. The Department of Revenue estimates that the modifications in product definitions to comply with the SSUTA would result in a reduction in state sales tax revenues of \$4,000,000 in 2009-10 and \$5,300,000 in 2010-11. However, the Department also estimates that sales tax revenues would increase by \$6,000,000 in 2009-10 and \$8,000,000 in 2010-11 as a result of voluntary collections, including those volunteering in order to take advantage of the amnesty provisions. The net

effect of these provisions would be an increase in state sales tax revenues of \$2,000,000 in 2009-10 and \$2,700,000 in 2010-11.

Legality Involved

There are no questions of legality involved in the provisions of the bill described in this report.

Public Policy Involved

The proposal is good public policy.

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