

*STATE OF WISCONSIN**REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**2015 SENATE BILL 503*

[Introduced by Senators Marklein, Gudex, Olsen and Roth; cosponsored by Representatives Macco, Kooyenga, Katsma, Jarchow, Novak, Tauchen, Duchow, Knodl, E. Brooks, R. Brooks, Jacque and Murphy.]

**General Nature of the Proposal**

2015 Senate Bill 503 makes numerous changes to state income and sales tax law, as well as the administration of tax laws by the Department of Revenue (DOR). These changes include the following:

- Revision of DOR practices regarding the imposition of penalties for a taxpayer's failure to produce records upon DOR request.
- Revision of the standard used to define whether a transaction has "economic substance" to adopt by reference certain federal economic substance provisions.
- Revision of evidentiary standards related to transactions between members of a controlled group.
- Revision to the treatment of indirect costs for purposes of calculating qualified production activity income under the manufacturing and agriculture income tax credit.
- Revision to DOR general authority to require the promulgation of administrative rules regarding criteria used to determine whether a taxpayer has sufficient nexus with the state for purposes of determining whether and to what extent the state may collect taxes from the taxpayer.
- Repeal of DOR authority to participate in the Multi-State Tax Commission audit program.
- Revision to an administrative provision relating to taxpayer reliance on prior audits to delete an exclusion from such reliance in instances when a taxpayer does not provide DOR with adequate and accurate information.
- Expansion of the sales and use tax exemption for lump sum contracts.

With regard to the sales and use tax exemption for lump sum contracts, the bill would expand the exemption to apply to all construction contracts involving real property construction activities if the total sales price of the taxable materials is less than 10% of the total contract price. The bill provides that, if a prime contract qualifies for the exemption, the exemption applies to all subcontracts. Alternatively, an individual subcontract may also qualify for the exemption if the sales price of construction materials is less than 10% of the total amount of the subcontract. When the exemption applies to a prime contract, the prime contractor is the consumer of, and pays the sales tax on, the materials. Similarly, the subcontractor is the consumer of the materials when an exemption applies to an individual subcontract.

**Legality Involved**

There are no issues of legality involved.

**Fiscal Effect Upon the State and Its Subdivisions**

In its fiscal estimate, DOR indicates that the expansion of the sales and use tax exemption for lump sum contracts would result in a decrease of state sales tax revenue of \$1.1 million and a decrease of local sales tax revenue of about \$79,000 per year. The other provisions of the bill have more complex fiscal effects. For example, DOR estimates an annual reduction of \$296 million in income tax revenue related to the treatment of "economic substance" but also indicates that this portion of the fiscal estimate is based on a technical drafting concern and could be reduced to zero with a clarifying amendment. Estimates for other provisions are indeterminate but illustrated by contextual examples. DOR estimates that the total fiscal effect of the bill would reduce revenue by \$335 million to \$384 million on an annual basis. The fiscal effect of the entire bill may be viewed in the fiscal estimate provided by DOR.

**Public Policy Involved**

The Joint Survey Committee on Tax Exemptions finds that with the changes proposed in Assembly Substitute Amendment 1 to Assembly Bill 623, there is appropriate public policy on the tax exemptions in Senate Bill 503.

01/28/16

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