

Fiscal Estimate - 2005 Session

Original
 Updated
 Corrected
 Supplemental

LRB Number 05-3801/1	Introduction Number AB-913
Description An income and franchise tax credit for the sales and use tax paid on construction materials, labor, and services that are sold under a lump sum contract	
Fiscal Effect	
State:	
<input type="checkbox"/> No State Fiscal Effect <input checked="" type="checkbox"/> Indeterminate	
<input type="checkbox"/> Increase Existing Appropriations <input type="checkbox"/> Decrease Existing Appropriations <input type="checkbox"/> Create New Appropriations	<input type="checkbox"/> Increase Existing Revenues <input checked="" type="checkbox"/> Decrease Existing Revenues
<input checked="" type="checkbox"/> Increase Costs - May be possible to absorb within agency's budget <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Decrease Costs	
Local:	
<input type="checkbox"/> No Local Government Costs <input type="checkbox"/> Indeterminate	
1. <input type="checkbox"/> Increase Costs <input type="checkbox"/> Permissive <input type="checkbox"/> Mandatory 2. <input type="checkbox"/> Decrease Costs <input type="checkbox"/> Permissive <input type="checkbox"/> Mandatory	3. <input type="checkbox"/> Increase Revenue <input type="checkbox"/> Permissive <input type="checkbox"/> Mandatory 4. <input type="checkbox"/> Decrease Revenue <input type="checkbox"/> Permissive <input type="checkbox"/> Mandatory
5. Types of Local Government Units Affected <input type="checkbox"/> Towns <input type="checkbox"/> Village <input type="checkbox"/> Cities <input type="checkbox"/> Counties <input type="checkbox"/> Others <input type="checkbox"/> School Districts <input type="checkbox"/> WTCS Districts	
Fund Sources Affected	
<input type="checkbox"/> GPR <input type="checkbox"/> FED <input type="checkbox"/> PRO <input type="checkbox"/> PRS <input type="checkbox"/> SEG <input type="checkbox"/> SEGS	
Affected Ch. 20 Appropriations	
Agency/Prepared By	Authorized Signature
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Date	
1/17/2006	

Fiscal Estimate Narratives
DOR 1/18/2006

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Description An income and franchise tax credit for the sales and use tax paid on construction materials, labor, and services that are sold under a lump sum contract					

Assumptions Used in Arriving at Fiscal Estimate

Under current law, contractors' charges for real property construction are not subject to sales or use tax but contractors' purchases of building materials are taxable. In contrast, a contractor's sales of personal property and taxable services (e.g., a stove and installation charges) are taxable even if the sale is included within a real property construction contract. Thus, contractors have to determine whether they are selling nontaxable real property construction services or personal property and taxable services. If an audit shows a contractor did not pay sales tax on sales of personal property or taxable services, he is liable for the tax, interest and penalty.

The bill creates an income and franchise tax credit for the sales and use taxes that a contractor or subcontractor paid on certain construction materials and services. The credit is equal to the sales and use taxes paid on any amount charged for tangible personal property or taxable services that are sold as a part of a lump sum contract, if the total of all such amounts is less than 10 percent of the total amount of the contract, and regardless of whether the amounts charged for labor and services are separately set forth from the amount received for the tangible personal property. Under the proposal, a lump sum contract is a contract to perform real property construction activities and for which the contractor quotes the charge for labor, services of subcontractors, and materials as one price, including a contract for which the contractor subsequently itemizes the charges for labor, services of subcontractors, and materials as part of a schedule of values or similar document. The credit would first apply to 2006.

The bill is not clear regarding the taxable sales for which a contractor could claim the new income and franchise tax credit. Depending on the interpretation of the bill language, the estimated fiscal effect could range from \$675,000 to \$58 million per year. Thus, the fiscal effect is indeterminate and indicates the need for clarification of the bill.

The lower bound of the fiscal estimate is determined as follows: The 2002 Economic Census reports "retail trade" as a component of the value of business done by construction companies. Nationally, construction company retail trade was \$1.18 billion in 2002. Assuming Wisconsin construction companies share (1.94%) of retail trade is the same as their share of total value of business done, and adjusting for government and other exempt purchasers, the value of retail trade of Wisconsin construction companies would be \$16.7 million ($\$1.18 \text{ bil.} \times 1.94\% \times 73\%$) in 2002. State sales and use tax on that amount would be \$830,000 and county and stadium taxes, currently 7.63% of state sales and use taxes, would increase the total to \$900,000. Assuming 75% of eligible filers claim the credit, state revenues would decrease by about \$675,000.

As indicated, it is unclear how much sales and use tax paid on construction would be affected by the credit under the draft. At a maximum, the bill draft may allow contractors to separate their charges into two contracts to take advantage of the tax credit. Under such a scenario, the cost of labor and other nontaxable charges would be 90% of the value of the first contract and the remaining 10% would be construction materials and taxable services. A second contract would be the charge for the construction materials and taxable services not included in the first contract. Under this interpretation, based on 2002 data, contractors may be able to apply for corporate and income tax credits of up to \$70 million.

This upper estimate is calculated as follows. According to the 2002 Economic Census, the total value of construction work in Wisconsin was \$23.0 billion in 2002, and the cost of materials and fuels for construction was \$6.9 billion. Thus, the value of construction work minus the value of materials, components and supplies was \$16.1 billion ($\$23.0 \text{ bil.} - 6.9 \text{ bil.}$) -- this amount determines the amount of income and franchise tax credit that may be claimed under the bill. Assuming \$16.1 billion is 90% of the sum of the first contracts, the remaining 10% would be \$1.8 billion of taxable construction materials and services. Adjusting for the cost of fuel and exempt sales, sales of materials, components and supplies reduces the amount of construction materials to \$1.3 billion. State sales and use tax on the \$1.3 billion of materials, components,

supplies would be \$65 million (\$1.3 bil. x 5%). County and stadium sales and use taxes are currently 7.63% of state sales and use taxes. Assuming this percentage does not change, local sales and use taxes are an additional \$5 million bringing total sales and use taxes to about \$70 million in 2002.

According to the 2003 corporate tax sample, corporate construction companies paid \$5.3 million in corporate tax while unincorporated construction companies paid \$53 million in individual income tax. Thus, in the aggregate, construction company corporate and individual income tax – \$58 million – could be fully offset by the credits under the bill. Data are not available to determine how the credits would be distributed among contractors.

Administrative costs of the bill draft would be absorbed by the department.

Long-Range Fiscal Implications