

2009 DRAFTING REQUEST

Bill

Received: **12/18/2008**

Received By: **jkreye**

Wanted: **As time permits**

Identical to LRB:

For: **Administration-Budget**

By/Representing: **Lillethun**

This file may be shown to any legislator: **NO**

Drafter: **jkreye**

May Contact:

Addl. Drafters:

Subject: **Tax, Other - sales**

Extra Copies:

Submit via email: **NO**

Pre Topic:

DOA:.....Lillethun, BB0291 -

Topic:

Require direct use for manufacturing sales and use tax exemption

Instructions:

See attached

Drafting History:

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/?	jkreye 12/18/2008	kfollett 12/19/2008		_____			S&L Tax
/1			rschluet 12/19/2008	_____	mbarman 12/19/2008		

FE Sent For:

<END>

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/?	jkreye	11/5/08 12/1/08	8 12/4/08	MD			

FE Sent For:

<END>

1221

2007-09 Budget Bill Statutory Language Drafting Request

- Topic: Require Direct Use for Manufacturing Sales/Use Tax Exemption
- Tracking Code: *BB0291*
- SBO team: Tax, Transportation and Budget Development Team
- SBO analyst: Chad Lillethun
 - Phone: 266-7597
 - Email: Chad.Lillethun@wisconsin.gov
- Agency acronym: DOR
- Agency number: 566
- Priority (Low, Medium, High): High

Intent:

Require exclusive and direct use by a manufacturer in the scope of manufacturing for materials to be eligible for sales tax exemption.

FISCAL EFFECT

This law change would explicitly state the requirement that items claimed to be exempt under sec. 77.54(2), Wis. Stats. (2005-06) must be exclusively consumed, destroyed, or lose their identity in activities performed by a manufacturer which are within the scope of manufacturing. This change will reverse the revenue loss for sales or use tax purposes as a result of *Cherney*. Since the Department of Revenue non-acquiesced to this WTAC decision, this fiscal impact is expected to be minimal.

If this change is not passed, however, the State of Wisconsin could face a significant loss of revenue in view of the decision of the WTAC in the case of *Cherney Microbiological Services, LTD. vs. Wisconsin Department of Revenue* dated April 23, 1996, Docket 94-S-209 since it is unclear to what extent the WTAC will allow the exemption to apply to tangible personal property purchased by persons:

- (1) who themselves are not manufacturers, but perform work that is not within the scope of manufacturing for manufacturers (e.g., tangible personal property purchased by janitorial service providers hired by manufacturers) and,
- (2) who are manufacturers but consume or destroy tangible personal property in activities that are not within the scope of manufacturing (e.g., tangible personal property consumed in a manufacturer's accounting department).

a In sum, this proposal is meant to reverse both the direct and potential effects of the *Cherney* decision.

DRAFTING INSTRUCTIONS

See 2009 LRB 42/P2.

EFFECTIVE DATE AND/OR INITIAL APPLICABILITY

Effective for purchases made on or after the first day of the 2nd month after publication.

INTERESTED/AFFECTED PARTIES

Manufacturers will be opposed as they argue all business inputs should be exempt from sales tax because the products they sell will ultimately be taxed when the tangible personal property manufactured is sold to the end user.

DOR CONTACT PERSON

Diane Hardt, Division Administrator
(608) 266-6798

PREPARED BY

Mike Hinnendael

2009-2011 Legislative Proposal
Wisconsin Department of Revenue
IS&E Division

Fiscal Effect?

Date: November 25, 2008

TITLE: Require Exclusive and Direct Use for Manufacturing Sales/Use Tax Exemption

DESCRIPTION OF CURRENT LAW AND PROBLEM

Section 77.54(2), Wis. Stats. (2005-06), provides a sales and use tax exemption for:

The gross receipts from sales of and the storage, use or other consumption of tangible personal property becoming an ingredient or component part of an article of tangible personal property or which is consumed or destroyed or loses its identity in the manufacture of tangible personal property in any form destined for sale, but this exemption shall not include fuel or electricity.

This section does not specifically state that the tangible personal property be **exclusively** consumed, destroyed, or lose its identity **in the scope of manufacturing**. It only requires that the items are consumed or destroyed or lose their identity "in the manufacture" of tangible personal property in any form destined for sale. (Note: There appears to be no problem with the "tangible personal property becoming an ingredient or component part" language. Therefore, this proposal should not affect that language.)

The Wisconsin Tax Appeals Commission (WTAC), in the case of *Cherney Microbiological Services, LTD. vs. Wisconsin Department of Revenue* dated April 23, 1996, Docket 94-S-209, concluded that the items included in the exemption language in sec. 77.54(2), Wis. Stats., do not need to be consumed or destroyed by a manufacturer. The Department of Revenue's long-standing position is that for this exemption to apply, the items must be consumed or destroyed by the manufacturer. The department's position is reflected in sec. Tax 11.41(3)(b), Wis. Adm. Code, August 1999 Register, which has been in this administrative rule since 1977 when the rule was first adopted. [The WTAC has invalidated this requirement in the *Cherney* decision.]

✎ The department's position was supported by past case law including *Astra Plating, Inc. v. Wisconsin Department of Revenue*, WTAC Docket Nos. I-6885 and S-6886, June 30, 1980, and *Anderson Laboratories, Inc. v. Wisconsin Department of Revenue*, WTAC Docket No. S-8212, December 10, 1985. However, the WTAC indicated in *Cherney* that "The above decisions. . . each involved a consumed materials exemption which was, perhaps mistakenly, intertwined with a machinery and equipment exemption in the Commission's determinations." The WTAC went on to say in *Cherney* that "The Commission simply did not explore the distinct wording of the two exemption statutes, §§ 77.54(2) and (6)(a), Stats."

✎ By invalidating the requirement that the items must be consumed or destroyed **exclusively** in the scope of manufacturing **by a manufacturer**, it may be argued by some that items **indirectly** consumed or destroyed by a manufacturer in the manufacture of tangible personal property destined for sale qualify for this exemption. This may include office supplies (paper, pens, computers, etc.), janitorial supplies (cleaning supplies, light bulbs, etc.), and any other tangible personal property which is consumed, destroyed, or loses its identity in the manufacture of tangible personal property in any form destined for sale. This would result in a significant loss of revenue to the State of Wisconsin.

Example - Manufacturer A purchases pens, pencils, and paper. The items are used by employees of Manufacturer A in the accounting department to prepare Manufacturer A's financial statements. Since the pens, pencils, and paper are consumed by Manufacturer A, although not exclusively in the scope of manufacturing, it may be argued that these items qualify for the exemption allowed in sec. 77.54(2), Wis. Stats. (2005-06). The department's current position is that these items would not qualify for this exemption because the items were not consumed or destroyed exclusively in the scope of manufacturing.

In addition to allowing exemption for items consumed or destroyed by persons performing work for manufacturers in the scope of manufacturing, it may be argued that the exemption also applies to items consumed or destroyed by persons performing work for a manufacturer, even if such items are not exclusively consumed or destroyed in the scope of manufacturing tangible personal property.

Example - Manufacturer A hires Janitor B to clean Manufacturer A's manufacturing plant. Janitor B consumes and destroys various items of tangible personal property, such as brooms, chemicals, and mops, while performing this janitorial service. Since the items (i.e. the brooms, chemicals, and mops) being consumed and destroyed are tangible personal property and the items are being consumed or destroyed in a process that is indirectly related to the manufacturing process, it may be argued that the items consumed or destroyed by Janitor B while performing work for Manufacturer A qualify for the exemption under sec. 77.54(2), Wis. Stats. (2005-06).

RECOMMENDATION FOR ACTION

Amend sec. 77.54(2) and (2m), Wis. Stats. (2005-06) to require exclusive and direct use by a manufacturer in the scope of manufacturing and provide a definition for the scope of manufacturing.

Require that items consumed, destroyed, or losing their identity in manufacturing tangible personal property destined for sale be exclusively consumed or destroyed by a manufacturer in activities which are within the scope of manufacturing.

ADMINISTRATIVE IMPACT

By including the language which indicates when manufacturing begins and ends, taxpayers will have a better understanding of what is and what is not included in the definition of manufacturing. In addition, by providing a definition of "plant," taxpayers will also have a better understanding of what is and what is not considered to be within the "same plant."

FAIRNESS / TAX EQUITY

The exemption for manufacturing machinery is limited to exclusive and direct use as are most other use-based exemptions (e.g. farming, common carriage). This recommendation provides consistent treatment for items consumed, destroyed or losing their identify in manufacturing tangible personal property destined for sale.

IMPACT ON ECONOMIC DEVELOPMENT

No significant impact anticipated.

1221/1

DOA - Budget BB0291

PRELIMINARY DRAFT - NOT READY FOR INTRODUCTION

in 12-18-08

do not give

1 AN ACT ~~to renumber 77.54 (6m) (a); to renumber and amend 77.54 (6m)~~
 2 ~~(intro.) and 77.54 (6m) (b); to amend 71.07 (3s) (a) 1., 71.28 (3) (a) 1., 71.47 (3)~~
 3 ~~(a) 1., 77.54 (2) and 77.54 (2m); and to create 77.51 (7m) (a) 3., 77.51 (7m) (b),~~
 4 ~~77.51 (10m) and 77.51 (10n) of the statutes; relating to: the sale of tangible~~
 5 ~~personal property consumed in manufacturing.~~ *the budget*

TAXATION
OTHER TAXATION

Analysis by the Legislative Reference Bureau

Under current law, generally, the sale of tangible personal property that becomes an ingredient or component part of an article of tangible personal property, or is consumed, destroyed, or loses its identity in manufacturing an article of tangible personal property is exempt from the sales and use tax. This bill provides that the sale of such tangible personal property is only exempt from the sales and use tax if it is also used exclusively and directly by a manufacturer in manufacturing an article of tangible personal property that is destined for sale.

Under current law, for sales and use tax purposes, "manufacturing" means the production by machinery of a new article of tangible personal property with a different form, use, and name from existing materials, by a process popularly regarded as manufacturing. The bill provides that the production begins with conveying raw materials and supplies from plant inventory to the place where work is performed in the same plant and ends with conveying finished units of tangible personal property to the point of first storage in the same plant.

Under current law, for sales and use tax purposes, "manufacturing" includes crushing, washing, grading, and blending sand, rock, gravel, and other minerals and

ore dressing. Under the bill, “manufacturing” also includes conveying work in progress directly from one manufacturing process to another in the same plant; testing or inspecting the new article of tangible personal property that is being manufactured; storing work in progress in the same plant where the manufacturing occurs; assembling finished units of tangible personal property; and packaging a new article of tangible personal property, if the manufacturer, or another person on the manufacturer’s behalf, performs the packaging and if the packaging becomes part of the new article of tangible personal property as it is customarily offered for sale by the manufacturer.

Because this bill relates to an exemption from state or local taxes, it may be referred to the Joint Survey Committee on Tax Exemptions for a report to be printed as an appendix to the bill.

For further information see the *state and local* fiscal estimate, which will be printed as an appendix to this bill.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

1 **SECTION 1.** 71.07 (3s) (a) 1. of the statutes is amended to read:

2 71.07 **(3s)** (a) 1. “Manufacturing” has the meaning given in s. 77.54 (6m), 2007
3 stats.

4 **SECTION 2.** 71.28 (3) (a) 1. of the statutes is amended to read:

5 71.28 **(3)** (a) 1. “Manufacturing” has the meaning given in s. 77.54 (6m), 2007
6 stats.

7 **SECTION 3.** 71.47 (3) (a) 1. of the statutes is amended to read:

8 71.47 **(3)** (a) 1. “Manufacturing” has the meaning given in s. 77.54 (6m), 2007
9 stats.

10 **SECTION 4.** 77.51 (7m) (a) 3. of the statutes is created to read:

11 77.51 **(7m)** (a) 3. Conveying work in progress directly from one manufacturing
12 process to another in the same plant; testing or inspecting, throughout the
13 manufacturing process, the new article of tangible personal property that is being
14 manufactured; storing work in progress in the same plant where the manufacturing

1 occurs; assembling finished units of tangible personal property; and packaging a new
2 article of tangible personal property, if the manufacturer, or another person on the
3 manufacturer's behalf, performs the packaging and if the packaging becomes part
4 of the new article as it is customarily offered for sale by the manufacturer.

5 **SECTION 5.** 77.51 (7m) (b) of the statutes is created to read:

6 77.51 **(7m)** (b) "Manufacturing" does not include storing raw materials or
7 finished units of tangible personal property, research or development, delivery to or
8 from the plant, or repairing or maintaining plant facilities.

9 **SECTION 6.** 77.51 (10m) of the statutes is created to read:

10 77.51 **(10m)** For purposes of sub. (7m), "plant" means a parcel of property or
11 adjoining parcels of property, including parcels that are separated only by a public
12 road, and the buildings, machinery, and equipment that are located on the parcel,
13 that are owned by or leased to the manufacturer.

14 **SECTION 7.** 77.51 (10n) of the statutes is created to read:

15 77.51 **(10n)** For purposes of sub. (7m), "plant inventory" does not include
16 unsevered mineral deposits.

17 **SECTION 8.** 77.54 (2) of the statutes is amended to read:

18 77.54 **(2)** The gross receipts from sales of and the storage, use or other
19 consumption of tangible personal property ~~becoming~~ that is used exclusively and
20 directly by a manufacturer in manufacturing an article of tangible personal property
21 that is destined for sale and that becomes an ingredient or component part of an ~~the~~
22 article of tangible personal property destined for sale or ~~which~~ is consumed or
23 destroyed or loses its identity in the ~~manufacture~~ manufacturing the article of
24 tangible personal property ~~in any form~~ destined for sale, except as provided in sub.
25 (30) (a) 6.

1 **SECTION 9.** 77.54 (2m) of the statutes is amended to read:

2 **77.54 (2m)** The gross receipts from the sales of and the storage, use or other
3 consumption of tangible personal property or services that are used exclusively and
4 directly by a manufacturer in manufacturing shoppers guides, newspapers, or
5 periodicals and that become an ingredient or component of shoppers guides,
6 newspapers, or periodicals or that are consumed or lose their identity in the
7 manufacture of shoppers guides, newspapers, or periodicals, whether or not the
8 shoppers guides, newspapers, or periodicals are transferred without charge to the
9 recipient. In this subsection, “shoppers guides”, “newspapers,” and “periodicals”
10 have the meanings under sub. (15). The exemption under this subdivision does not
11 apply to advertising supplements that are not newspapers.

12 **SECTION 10.** 77.54 (6m) (intro.) of the statutes is renumbered 77.51 (7m) (a)
13 (intro.) and amended to read:

14 **77.51 (7m) (a) (intro.)** ~~For purposes of sub. (6) (a) “manufacturing” is~~
15 “Manufacturing” means the production by machinery of a new article of tangible
16 personal property with a different form, use, and name from existing materials, by
17 a process popularly regarded as manufacturing, and that begins with conveying raw
18 materials and supplies from plant inventory to the place where work is performed
19 in the same plant and ends with conveying finished units of tangible personal
20 property to the point of first storage in the same plant. “Manufacturing” includes but
21 is not limited to:

22 **SECTION 11.** 77.54 (6m) (a) of the statutes is renumbered 77.51 (7m) (a) 1.

23 **SECTION 12.** 77.54 (6m) (b) of the statutes is renumbered 77.51 (7m) (a) 2. and
24 amended to read:

1 77.51 (7m) (a) 2. Ore dressing, including the mechanical preparation, by
2 crushing and other processes, and the concentration, by flotation and other
3 processes, of ore, and beneficiation, including but not limited to the preparation of
4 ore for smelting.

change components

SECTION 13. Effective date.

Revenue

6 (1) This act takes effect on the first day of the 2nd month beginning after
7 publication.

8 (END)

TANGIBLE PERSONAL PROPERTY CONSUMED IN MANUFACTURING.

no ff

and

no ff the renumbering of section 77.54(6m)(a) of the statute, the
renumbering and amendment of section 77.54(6m)(intro.) and (b)
of the statute, the amendment of sections 71.07(3s)(a)1.,
71.28(3)(a)1., 71.47(3)(a)1., and 77.54(2) and (2m) of the
statute, and the creation of section 77.51(7m)(a)3. and (b),
(10m), and (10n) of the statute

The treatment of





State of Wisconsin
2009 - 2010 LEGISLATURE

LRB-1221/1

JK:kjf:rs

DOA:.....Lillethun, BB0291 - Require direct use for manufacturing sales and use tax exemption

FOR 2009-11 BUDGET -- NOT READY FOR INTRODUCTION

1 AN ACT ...; relating to: the budget.

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