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Construction Sales Tax Simplification

Wisconsin's construction sales tax is complicated and difficult to administer as it pertains to the way we treat certain products that are part of a construction sale. Under current law, the contractor is the end consumer of good and materials that the use to construct a building – things such as the bricks, mortar and lumber to build the product – and as the consumer of those products the contractor pays the sales tax on those “real property” items. The complication comes in when the contractor includes things defined as “personal property” items in their project that are included in the price of the contractor's contract. A great example of this is appliances like a refrigerator. Many times as a mortgage loan originator I saw an increased number of these things being added into the construction price of building a home for my borrowers – and there are good reasons to do that in the simplification of the home loan and not needing thousands of dollars of additional monies right after closing on the purchase of the home in order to outfit it with the personal property items that are considered to be needed in a home.....things like refrigerators and cooking ranges. In this instance though then end homeowner is now the purchaser of these “personal property” items and must pay the sales tax, not the contractor.

Current law was clarified in 2013 so that if up to 10% of the purchase price of a building that is sold in a “lump-sum” contract price is personal property, then the contractor can simply pay the sales tax up front and not have to split this personal property out of the lump sum contract and do a separate sale to the homeowner and collect the sales tax separately. Current law for all construction contracts other than those defined as “lump sum” contracts still require the contractor to charge the end owner sales tax on these personal property products regardless of the percentage of total contract price. This bill expands the current 10% exemption allowed on lump sum contracts and extends it to all types of construction contracts – including contracts like “cost plus contract” contracts or any other contract used as the method of purchase. This bill simply would make the 10% exemption rule consistent across the various structure methods of the construction contract instead of the current law that only applies to one type of construction contract.

Just to be clear, this bill does not exempt any materials from the sales tax. The sales taxes are still paid, the change just allows the contractor to pay those taxes up front and doesn't distinguish between the different structuring methods of construction contracts.



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Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

June 15, 2017

Testimony to the Assembly Committee on Ways & Means on Assembly Bill 340

Chairman Macco and members of the committee, thank you for the opportunity to testify on Assembly Bill 340, which expands the exemption for the lump sum contract.

A "lump sum contract" is a contract for which the contractor quotes the charge for the labor and services of subcontractors and the taxable products and services as one price. Under current law, there is a sales and use tax exemption for property, items, and services sold by a contractor as part of a lump sum contract for real property construction activities if the total sales price attributable to the taxable products is less than 10 percent of the total contract price. The contractor is the consumer of such taxable products and is liable for sales or use tax on its purchase of these products. This exemption was created in the 2013 Budget Bill.

Assembly Bill 340 expands the exemption for lump sum contracts to apply to all construction contracts involving real property construction activities if the total sales price of the taxable products is less than 10 percent of the total contract price.

For example this bill would expand the treatment of lump sum contracts to "time and materials contracts." For a "lump sum contract," the contract is quoted by the contractor as one price. For a "time and materials contract," the customer may be billed for materials and an hourly rate for labor. Currently this type of contract does not qualify for exemption under current law.

The bill also provides that if the prime contractor qualifies for the exemption, the exemption also applies to all subcontracts entered into with respect to the real property construction activities. If the exemption applies to the subcontract, the subcontractor owes tax on its purchase of the materials. Thank you again for the opportunity to discuss AB 340.



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TO: Members of the Assembly Ways and Means Committee
FROM: Nicole Kuehl, Legislative Advisor
RE: AB 340 & AB 289
DATE: June 16, 2017

Assembly Bill 340: relating to a sales and use tax exemption for products sold in connection with real property construction activities.

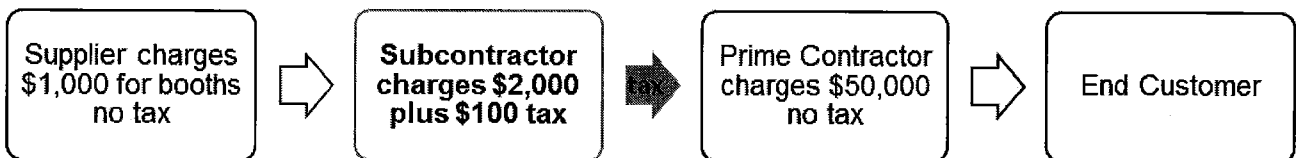
There were numerous questions from committee members regarding the fiscal impact of AB 340. This bill decreases revenues because the total price subject to tax is reduced. Our fiscal estimate states, "The bill reduces the price subject to tax on eligible products from the subcontractor's sale price (including installation, labor charges, and markup) to the subcontractor's purchase price."

Below please find a short narrative and flow chart that seeks to illustrate a real world example for real property improvement contracts in which the total sales price of taxable products is less than 10% of the total contact price.

Current law:

Subcontractor purchases restaurant booths from supplier for \$1,000 without tax for resale. Subcontractor installs booths for prime contractor for \$2,000 (sales price includes markup and labor for installation), which is subject to tax. Subcontractor collects \$100 of sales tax from prime contractor (\$2,000 x 5% = \$100). The prime contractor's sale of \$50,000 of real property improvements is not taxable

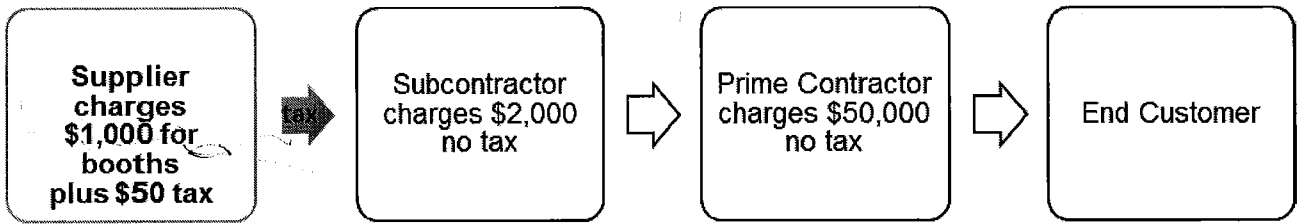
Total tax paid is \$100.



Under this proposal:

Subcontractor purchases restaurant booths from supplier for \$1,000 and pays sales tax to vendor of \$50 (\$1,000 x 5% = \$50). Subcontractor installs booths for prime contractor for \$2,000 (which includes markup and labor for installation), which is exempt from tax. The prime contractor's sale of \$50,000 of real property improvements is not taxable.

Total tax paid is \$50.



Assembly Bill 289: relating to exempting from taxation the value of Olympic medals and certain payments received by Olympic athletes.

Committee members had questions on the amount of prize money associated with each medal as well as how the medals were valued. Gold medal recipients receive \$25,000, silver medal recipients receive \$15,000 and bronze medal recipients receive \$10,000. The value of the medals is based on current commodity trading prices. A gold medal is worth approximately \$600, a silver medal is worth approximately \$300, and a bronze medal is worth approximately \$4.

The Governor's proposed budget has a provision that would adopt the federal treatment on this issue, which is to exempt from taxation the value of the medals and prize money received by Olympic athletes. However, under federal law this exemption does not apply to athletes that earn more than \$1,000,000 in adjusted gross income. This bill does not apply that exclusion.

Jeff Graves, CFO, Staab Construction Corporation

AB340 Testimony - Thursday, June 15, 2017

Good morning and thank you for allowing me to speak on this important Bill. My name is Jeff Graves and I am the Chief Financial Officer for Staab Construction Corporation. Staab Construction is an employee owned General Contractor based in Marshfield Wisconsin. Staab builds municipal and industrial water and wastewater treatment facilities, water control structures and dams throughout Wisconsin and the Midwest.

While I am here representing Staab Construction, I am speaking on behalf of the Associated General Contractors of Wisconsin, whose contractor members share my frustration in dealing with sales tax issues in Wisconsin.

In my role as CFO I have to deal with sales tax issues on a daily basis, and dealing with this issue on our Wisconsin projects is overly time consuming and complicated. Unnecessary confusion on interpretation and compliance exists with owners, engineers, general contractors, and subcontractors. Misinterpretation on sales tax can have a significant impact on already thin profit margins.

AB 340 would expand the 10% rule to apply to all construction projects, whether they are sold under a lump sum price, a cost-plus contract or any other method of purchase. The majority of construction contracts are already covered by the lump sum rule, this change would simply make the rule consistent no matter how the contract is structured.

AB340 also clarifies that subcontractors can purchase materials using the same process as prime contractors on behalf of tax-exempt clients, which is important as subcontractors perform significant work in the industry.

This proposal does not exempt any materials from the sales tax. The sales taxes on the materials are still paid, this change only simplifies the law to allow the contractor to purchase all of the materials in the project and pay the sales taxes up front.

This proposed change will be cut red tape, and make doing business in Wisconsin much easier. In the end, the tax-exempt entity benefits from this cost savings.

Thank you for your time and allowing me to speak. I would be glad to answer any questions.