STATE OF WISCONSIN

REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS

1999 ASSEMBLY BILL 515

[Introduced by Seratti, Rhoades, Gronemus, Petrowski, Schneider, Ott, Suder, Freese, Ainsworth, Hundertmark, Schooff, Gard, Grothman, Hahn, Lassa, Albers, Gundrum, Pettis, Olsen, Hasenohrl, F. Lasee, Reynolds, Skindrud, Musser, Plouff, Jensen, Spillner, Wasserman, Kestell, Leibham, Gunderson, Sykora, Kreibich, Ward, Hutchison, Stone, Powers, Klusman, Johnsrud, Handrick, Brandemuehl, Kedzie, Townsend, Huebsch and Goetsch; cosponsored by Senators Breske, Drzewiecki, Roessler, Schultz, Zien, A. Lasee, Welch, Rude, Fitzgerald, Panzer, Lazich, Baumgart and Shibilski.]

General Nature of Proposal

Generally, under current law, tangible personal property used in the business of farming is subject to the sales and use tax. However, current law specifically exempts certain items of tangible personal property from the sales and use tax. For example, current law specifies that tractors and machines, including accessories, attachments and parts therefore, used exclusively and directly in the business of farming, are exempt from the sales and use tax. In addition, the following items are also exempt if they are used exclusively by the purchaser or the user in the business of farming: seeds for planting; plants; feed; fertilizer; soil conditioners; animal bedding; sprays, pesticides and fungicides; breeding and other livestock; poultry; farm work stock; bailing twine and bailing wire, containers for fruits, vegetables, grains, hay, silage and animal wastes; and plastic bags, plastic sleeves and plastic sheeting used to store or cover hay or silage.

Current law specifically does not exempt from the sales and use tax the sale of automobiles, trucks and other motor vehicles for highway use. In addition, personal property that is attached to, fastened to, connected to or built into real property or that becomes an addition to, a component of or capital improvement of real property are not exempt. In addition, tangible personal property used or consumed in the erection of buildings or in the alteration, repair or improvement of real property regardless of any contribution that the personal property makes to the production process in the building or real property and regardless of the extent to which the personal property functions as a machine is excluded from the exemption. However, certain items are exempt regardless of the extent to which they are fastened to, connected to or built into real property. Those items include:

1. Auxiliary power generators.
2. Bale loaders.
3. Barn cleaners and elevators.
4. Conveyors.
5. Feed elevators and augers.

6. Grain dryers and grinders.

7. Milk coolers.

8. Milking machines; including piping, pipeline washers and compressors.

9. Powered feeders; excluding platforms and troughs constructed from ordinary building materials.

10. Silo unloaders.

Under the bill, the exemption for tangible personal property used in farming is broadened to include all tangible personal property used in farming regardless of whether the tangible personal property is attached to or becomes part of the real property. Under the bill, tangible personal property that is consumed or loses its identity in the business of farming is also exempt from the sales tax and use tax. However, under the bill, automobiles, trucks and other motor vehicles for highway use would still be taxable. In addition, tangible personal property used or consumed in the erection of buildings or in the alteration, repair or improvement of real property would also continue to be taxable. Finally, the bill repeals several current specific farm-related definitions and exemptions for items used in farming because they would be included in the broader exemption created by the bill.

Legality Involved

There are no questions of legality involved.

Fiscal Effect Upon the State and Its Subdivisions

The Department of Revenue estimates the fiscal effect of the bill as follows:

> Under current law, unless specifically exempted in the statutes, tangible personal property that is used in the business of farming is subject to the sales and use tax. This bill would extend the current sales and use tax exemption for farmers to all remaining taxable supplies used in the business of farming. These include miscellaneous equipment and supplies; all vitamins, supplements and related supplies for livestock that are currently not exempt; and machines and materials that may become part of real property if they are an essential component to the farming operation.
>
> The total cost of the additional sales and use tax exemptions for equipment and supplies used in the business of farming related to this bill would be an estimated $7.9 million to $10.5 million annually. The following are the major categories of equipment and supplies that would become exempt under this bill along with the corresponding revenue loss:

<u>General Equipment and Supplies</u>: Based on data from the 1997 Census of Agriculture, market data from farm supply companies, and information from the University of Wisconsin-Extension, expanding the sales tax to all equipment and supplies used in the business of farming would cost an estimated $2.6 million to $5.2 million annually. According to the 1997 U.S. Census of Agriculture, Wisconsin farmers spent $523.8 million on miscellaneous farm production expenses. Miscellaneous expenses include items that are currently taxable; based on UW-Extension data and interviews with farmers, an estimated 10% to 20% of the items in this expense category are currently taxable. Exempting the remaining taxable supplies would reduce sales tax revenue between $2.6 million ($528.8 million x 10% x 5%) and $5.2 million ($528.8 million x 20% x 5%) annually.

<u>Vitamins, Supplements, and Related Supplies</u>: Data from major agricultural medicine and supplement manufacturers and the UW-Extension indicate that the spending for taxable hormones, feed supplements, and vitamins in Wisconsin is nearly $30 million; therefore, exempting these items would reduce revenue by an estimated $1.5 million ($30 million x 5%) annually.

<u>Real Property Improvement and Construction Supplies</u>: As currently drafted, the bill would exempt all building materials used in farm construction from the sales and use tax. According to the 1992 Census of Construction, the total value of farm construction in Wisconsin was $113 million. Based on data from the U.S. Census, the value of annual farm construction has grown 112% since 1992. Materials used in real property construction account for 32% of construction costs. The total value of materials used in real property construction in 1999 for Wisconsin is estimated at $76.7 million ($113 million x 2.12 x 0.32) annually. Therefore, the revenue loss associated with construction materials for farms is estimated at $3.8 million ($76.7 million x 5%) annually.

County and stadium sales tax revenues were 6.24% of state sales tax revenues in 1998. Assuming this percentage applies, county and stadium sales tax revenues would decline by approximately $0.5 million to $0.7 million annually.

Public Policy Involved

The bill is good public policy.

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February 21, 2000

TO: Senator Russell Decker
Room 323 South, State Capitol

FROM: Faith Russell, Fiscal Analyst

SUBJECT: Sales Tax Exemptions Related to Manufacturing and Farming

At your request, this memorandum discusses sales tax exemptions related to manufacturing and related to farming under current law and under 1999 Assembly Bill 515.

Current Law Manufacturing Sales Tax Exemptions

Machines and Processing Equipment

The statutes provide a sales tax exemption for the gross receipts from the sale, storage and use of machines and specific processing equipment used exclusively and directly by a manufacturer in manufacturing tangible personal property. The exemption also applies to safety attachments and to repair and replacement of parts of the exempt machines and processing equipment. For the purpose of this exemption, "manufacturing" is defined as the production by machinery of a new article with a different form, use and name from existing materials by a process popularly regarded as manufacturing.

Property Consumed or Destroyed in Manufacturing

A sales tax exemption is also provided for the gross receipts from the sale, storage or use of property that becomes an ingredient or component part of an article of tangible personal property or that is consumed or destroyed or loses its identity in the manufacture of personal property in a form destined for sale. This exemption does not apply to fuel and electricity. However, an income tax credit is available for sales tax paid on fuel and electricity used in manufacturing.

Current Law Farming Sales Tax Exemptions

Tractors and Machines

Sales Tax Exemption. Under current law, an exemption is provided for the gross receipts from the sale of tractors and machines, including accessories and parts, that are used exclusively and directly in the business of farming. "Used exclusively" means that at least 95% of the use of the property is in the business of farming. "Farming" includes dairy farming, agriculture, horticulture, floriculture and custom farming services.

The following items are specifically excluded from this exemption: (a) motor vehicles for highway use; (b) personal property that is attached to or becomes part of real property or becomes an addition to, component of or capital improvement of real property; and (c) tangible personal property that is used or consumed in constructing buildings or in the alteration, repair or improvement of real property.

Due to the exclusion described under (b), a machine is not generally exempt from the sales tax if it is attached to or becomes part of real property. However, the statutes provide that, for the purpose of the exemption, the following items retain their character as tangible personal property regardless of the extent to which they are fastened to, connected to or built into real property: (a) auxiliary power generators; (b) bale loaders; (c) barn cleaners and elevators; (d) conveyors; (e) feed elevators and augers; (f) grain dryers and grinders; (g) milk coolers; (h) milking machines, including piping, pipeline washers and compressors; (i) powered feeders; and (j) silo unloaders. As such items retain their characteristics as tangible personal property, they are not excluded from the sales tax exemption for machines, even when they become attached to or part of real property.

Comparison with Manufacturing Machinery Exemption. The farm tractor and machine exemption bears some similarities to the exemption for manufacturing machinery and equipment. Both exemptions relate to the gross receipts from the sale of machines and equipment. Both require direct and exclusive use for the exemption to apply. However, the two exemptions differ conceptually and with respect to specific provisions including the following:

a. The manufacturing exemption requires use in a specific <u>process</u> (manufacturing tangible personal property) by a specified user (a manufacturer). The farm machinery and equipment exemption relates to a <u>business</u> (farming), and does not specify a required class of users.

b. As established through case law, the manufacturing exemption applies to eligible machines and equipment whether or not they are attached to real property. In contrast, the farming exemption generally does not apply to personal property that is attached to or becomes part of real property (with the exceptions noted above).

Other Farming Exemptions

Sales Tax Exemptions. The gross receipts from the sale of the following items used exclusively in the business of farming are exempt from the sales tax: seeds; plants; feed; fertilizer; pesticides and related chemicals; livestock and poultry; baling wire and twine; animal bedding; milkhouse supplies; plastic sheeting; and certain containers used in farming. In addition, sales tax exemptions are provided for the following items: (a) livestock semen used for artificial insemination; (b) fuel and electricity sold for use in farming (prior to May 1, 2000, the electricity exemption is limited to electricity sold from November through April); (c) medicine used on farm livestock, not including workstock; and (d) animal tags and standard milk samples sold by the Department of Agriculture, Trade and Consumer Protection (DATCP). Veterinary medical and hospitalization services are not taxable services in Wisconsin.

Comparison with Manufacturing Exemption. As with the machinery exemptions, there are some similarities between the exemptions for other property used in farming and the general manufacturing exemption related to tangible personal property. In each case, the gross receipts from the sale of certain tangible personal property used in the industry are exempt from the sales tax. The differences in the exemptions include the following:

a. The manufacturing exemption related to tangible personal property (other than that covered under the machinery and equipment exemption) is a single, general exemption. For farming, there are multiple, specific exemptions related to the use of certain types of tangible personal property.

b. The manufacturing exemption requires that the tangible personal property must either: (a) become an ingredient or component of an article of tangible personal property; or (b) be consumed or destroyed or lose its identity in the manufacture of tangible personal property in a form destined for sale. The farming exemptions have no similar requirement.

c. While a sales tax exemption is provided for fuel and electricity sold for use in farming, the manufacturing exemption excludes fuel and electricity. As described previously, however, an income tax credit is available for sales taxes paid on fuel and electricity used in manufacturing.

Farming Exemptions under 1999 Assembly Bill 515

Sales Tax Exemptions

Under 1999 Assembly Bill 515, with the exception of the exemption for animal tags sold by DATCP, the exemptions described above under "Other Farming Exemptions" would be repealed. In addition, the farm tractor and machinery exemption [s. 77.54(3)] would be amended as follows:

Expansion from Machines to Tangible Personal Property. The exemption would be extended to all tangible personal property (unless specifically excluded) used directly and exclusively in the business of farming, rather than applying to farm machines as under current law. The bill would also delete the current definition of a machine as an assemblage of parts that transmits force, motion and energy from one part to another in a predetermined manner. As under current law, the exemption would not apply to automobiles, trucks and other motor vehicles for highway use.

Treatment of Attachments to Real Property. The bill would eliminate the current exclusion under s. 77.54(3) of personal property that is attached to or becomes part of real property or that becomes an addition to, component of or capital improvement of real property. The bill would also repeal the related provision detailing items that retain their character as tangible personal property regardless of the extent to which they are fastened to, connected to or built into real property. Instead, the bill would specify that for the purpose of these provisions, "tangible personal property" includes tangible personal property that is fastened to, connected to or built into real property and tangible personal property that is consumed or loses its identity in the business of farming. These provisions would make such tangible personal property generally exempt, rather than generally taxable as under current law.

Treatment of Buildings and Real Property Improvements. The bill would delete the provision that specifies that "building" has the meaning given under s. 70.111(10)(a). Section 70.111(10)(a) defines building as follows:

> "Building" means any structure that is intended to be a permanent accession to real property; that is designed or used for sheltering people, animals or plants, for storing property or for working, office, parking, sales or display space, regardless of any contribution that the structure makes to the production process in it; that in physical appearance is annexed to that real property; that is covered by a roof or encloses space; that is not readily moved or disassembled; and that is commonly known to be a building because of its appearance and because of the materials of which it is constructed.

The bill would retain the provision that tangible personal property used or consumed in the erection of buildings is not eligible for the sales tax exemption. According to the Department of Revenue (DOR), deleting the definition of "building" while retaining the exclusion that refers to buildings may produce unintended results. Based on case law, certain structures used exclusively in the business of farming (such as greenhouses, barns and silos) may not qualify as "buildings" without a definition such as the one shown above. Without a definition that includes such structures, the gross receipts from sales of tangible personal property used or consumed in erecting them would become eligible for the sales tax exemption under 77.54(3). If the bill were amended so as not to repeal the definition of "building", the gross receipts from sales of tangible personal property used or consumed in erecting structures such as greenhouses, barns and silos would continue to be subject to the sales tax.

Treatment of Attachments to Real Property versus Real Property Improvements. The bill would retain the provision that tangible personal property used or consumed in the alteration, repair or improvement of real property is excluded from the sales tax exemption. This provision conflicts with the provision that "tangible personal property" includes tangible property that is fastened to, connected to or built into real property and tangible personal property that is consumed or loses its identity in the business of farming. The exclusion from the sales tax exemption of materials used to alter, repair or improve real property means that receipts from the sale of such materials would be subject to the tax. However, it is difficult to discern a distinction between such property and property that is fastened to, connected to or built into real property, which the "tangible personal property" provision would exempt from taxation. If the intention is to exempt such property, this could be done by amending the bill to repeal the provision excluding tangible personal property used or consumed in the alteration, repair or improvement of real property from the sales tax exemption.

There may also be unintended results from the repeal, under the bill, of the following sales tax exemptions: (a) the gross receipts from the sale of semen used for artificial insemination of livestock; and (b) the gross receipts from the sale, storage, use or other consumption of medicines used on farm livestock, not including workstock. Under current law, such items are exempt regardless of the purchaser. Under the bill, these items would be exempt only when used in the business of farming. Sales of such property to a veterinarian, which are currently exempt, would become taxable sales under AB 515.

Comparison with Manufacturing Exemptions

As described above, the bill would repeal all but one of the specific farming sales tax exemptions under current law and replace them with a general exemption for tangible personal property used exclusively and directly in the business of farming. According to DOR and similar to the manufacturing machinery and equipment exemption, the requirement under AB 515 that tangible personal property be used "exclusively and directly" in farming would exclude items used indirectly, such as office computers or other office equipment. As under current law, the farming exemptions under AB 515 would be conceptually different from the manufacturing exemptions in that they would be related to a <u>business</u> (farming) rather than a <u>process</u> (manufacturing). Also, as under current law, there would be no requirement for farming comparable to the requirement for the general manufacturing exemption for tangible personal property that property become a component of an article of tangible personal property or be consumed or destroyed in producing tangible personal property in a form destined for sale in order to qualify for the sales tax exemption.

An amendment is needed to resolve the conflicting treatment under AB 515 of tangible personal property used or consumed in the alteration, repair or improvement of real property (which would be taxable) and tangible personal property fastened to, connected to or built into real property or consumed in the business of farming (which would be exempt). One option would be to amend the bill to exempt all such tangible personal property from the sales tax. In this case, qualified machines used in both farming and manufacturing would be exempt from the sales tax regardless of the extent to which they became an addition to, component of, alteration or repair of real property. However, in contrast to the manufacturing exemption, such a farming exemption would apply to all tangible personal property used in connection with real property construction, alteration, repair and improvement, whether or not the property qualified as a machine.

I hope this information is useful. Please let me know if you have additional questions.

FR/lah