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STEPHEN R. MILLER
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February 13, 2008

MEMORANDUM

To: Representative Friske

From: Joseph T. Kreye, Sr. Legislative Attorney, (608) 266–2263

Subject: Technical Memorandum to **2007 AB 746** (LRB––3834/1) **by DOR**

We received the attached technical memorandum relating to your bill. This copy is for your information and your file.

If you wish to discuss this memorandum or the necessity of revising your bill or preparing an amendment, please contact me.

MEMORANDUM

February 13, 2008

TO: Joe Kreye
Legislative Reference Bureau

FROM: Paul Ziegler
Department of Revenue

SUBJECT: Technical Memorandum on AB 746 -- Video Game and Video Gaming Device Fees

The department has the following concerns about the bill:

1. Because the bill imposes a fee, rather than a tax, various provisions of the general sales and use tax law (Ch. 77, Subch. III) may not apply to the new 1% fee.

   Example 1. Sec. 77.52(1d), as created in sec. 18 of the bill, imposes the new 1% fee on retailers. Presumably, the intention of the bill is to allow these retailers to collect the fee from their customers in the same way they collect sales taxes. However, sec. 77.52(3), which authorizes retailers to collect sales taxes from their customers, does not apply to the new 1% fee, because it is a fee rather than a tax. Therefore, retailers would be subject to the new 1% fee on their sales of video games and video gaming devices but would not have authority to collect this fee from their customers.

   Example 2. The definition of gross receipts in sec. 77.51(4)(a)4 should be referenced for the new 1% fee. Under the law, a retailer's taxable gross receipts do not include "...any tax imposed by the United States, any other *tax* imposed by this state...if that...*tax* is measured by a stated percentage of sales price or gross receipts..." (Emphasis added.) The "tax" referenced here is the sales tax. Thus, under current law, the sales tax collected by a retailer is not included in the retailer's "gross receipts" and the retailer does not have to pay sales tax on the sales tax it collects. Under the bill, however, the retailer would have to pay sales tax on the new 1% fee it collects from its customers, assuming sec. 77.52(3) is revised to allow retailers to collect this fee from their customers (see paragraph above).

   These are only two examples of the many provisions in the sales and use tax law that should be referenced for the new 1% fee.

   To correct this concern, it is suggested that the new 1% fee be imposed in a separate subchapter. Since the new 1% fee is not a sales tax, the fee should not be included in the general sales and use tax subchapter, subchapter III. Instead, a new subchapter could be created for the new fee, similar to the new subchapters that were created for other fees, such as the state rental vehicle fee, the dry cleaning fees, and the regional transit authority fee. This new subchapter could have a reference such as "Relation to subch. III. The provisions of subch. III that are consistent with this subchapter, as they

apply to the taxes under that subchapter, apply to the fees under this subchapter." This is similar to the reference in sec. 77.79, which applies to county and special district sales and use taxes.

In addition, placing the new 1% fee in a separate subchapter would prevent the fee from impacting Wisconsin's compliance with the Main Street Equity Act (Streamlined Sales and Use Tax Agreement). While the Main Street Equity Act was not passed into law in 2007, it has been introduced again. The result of moving the new 1% fee to a different subchapter and then not having Streamlined apply to this fee would be that only retailers with nexus would be required to collect and report the new 1% fee, and those without nexus would not be required to collect and report it.

Alternatively, if the provisions relating to the new 1% fee remain in subchapter III, this concern of imposing a fee rather than a tax could be corrected by adding a reference in subchapter III such as: "The provisions of this subchapter, as they apply to the taxes under this subchapter, also apply to the fees imposed under s. 77.52(1d) and s. 77.53(1d)."

2. The definition of "video game" is unclear. An important part of this definition is the phrase "any electronically operated game." Since the bill does not include a definition of "game," the dictionary definition applies.

Webster's New World College Dictionary, 2000, defines "game," in part, to mean:

> **1** any form of play or way of playing; amusement; recreation; sport; frolic; play **2** *a*) any specific contest, engagement, amusement, computer simulation, or sport involving physical or mental competition under specific rules, as football, chess or war games *b*) a single contest in such a competition *[*to win two out of three *games]*...**5** a set of equipment for a competitive amusement *[*to sell toys and *games]*...

Because this definition is very broad, the definition of "video game" may include property that is not intended to be included. This is illustrated by the following examples.

a. "Video game" may include educational computer software that involves a game of some type. The bill does not distinguish whether a video game is primarily educational in nature. Sales of educational software, such as that involving games to help children read or do arithmetic, would appear to be subject to the new 1% fee. If it is not intended for the fee to apply to such software, the bill should specify this. Given that litigation has occurred on sales tax issues on whether an event is educational or for entertainment purposes, however, it may be noted that such a distinction for the application of the video game fee, if added to this bill, may also lead to legal challenges.

b. "Video game" may include computer software that is primarily non-game software, but includes some video games. For example, operating system software usually includes some video games (e.g., Solitaire). Does such operating system software meet the definition of "video game" because it is included under "any electronically operated game?" Must a retailer of such operating system software allocate a portion of the selling price for the video games, and only pay the fee on this portion of the price? If it is not intended for the fee to apply, the definition of "video game" in

the bill should be revised to specify that "video game" does not include computer software that has a primary purpose other than to function as a game. If this approach is taken, "primary purpose" should be defined to mean more than 50%.

c. "Video game" may include board games that have a video game (such as on a CD or DVD) or video display included. Must a retailer allocate a portion of the selling price to the video game portion, and pay the fee on this portion? If the intention of the bill is to include such types of "video games," an administrative burden may be placed on retailers.

3. The definition of "video gaming device" is unclear.

a. The definition of "video gaming device" should be revised to delete the word "displaying" (page 7, line 25). This could be read to mean that a video game console that does not contain a display screen (for example, it might be connected to a television) does not meet the definition of "video gaming device" because the console is not used to display the games (the television displays the games). It would be sufficient to define "video gaming device" to mean a video game console or handheld device that is used primarily for video games.

b. Cellular telephones often include video games. A retailer would have no way of knowing whether a buyer's primary purpose is to use the phone to play video games.

c. A "video gaming device" may include a television remote control that is used to play games offered on a satellite television gaming channel. If so, would the satellite television programmer be expected to track the use of the remote control by the customer to determine which customers use their remote controls primarily to play video games?

d. A home computer may be a "video gaming device". However, a retailer would have no way of knowing whether the purchaser's primary intent is to display video games or to use it for another purpose, such as homework.

e. It is unclear which items are subject to the fee as accessories, components, attachments, parts, and supplies for video games and video gaming devices. For example, is a cable that attaches to a video gaming device an accessory or attachment for the device? Does it matter if the cable has multiple uses, such as connecting a DVD player to a television as well as connecting a video gaming device to a television? Is the retailer of such a multi-function accessory expected to determine whether the customer will use the accessory for a video gaming device and pay the fee on such sales? Would a television be subject to the fee as an attachment if it is purchased at the same time as the video gaming device and cable?

4. Page 9, lines 7-12. The fee imposed under sec. 77.53(1d) only applies to video games; it should also apply to video gaming devices, accessories, components, attachments, parts, and supplies.

5. Page 8, lines 2 and 23. The effect of adding "Except as provided in sub. (1d)," to sec. 77.52(1) and sec. 77.53(1) is not clear. These additions may not be necessary since the following paragraphs specify that the 1% fee is in addition to the sales and use tax.

Could these "except as provided" phrases possibly negate the 5% sales tax on video games and video gaming devices?

6. Page 8, line 9. The word "on" should be changed to "under." "In addition to the tax imposed *under* sub. (1)..."

7. Page 9, lines 16, 18, and 20. The words "and fees" should be added immediately after "taxes" on these lines. Then, all of the provisions relating to the retailer's discount will also apply to the new 1% fee. **Note:** This change is not needed if one of the suggested corrections to the fee versus tax issue in item #1 above is made.

8. The bill creates burdensome recordkeeping and reporting responsibilities for retailers selling video games and video gaming devices. Such retailers will have to keep track of such sales separately from other sales made, and report them to the Department of Revenue separately from other sales made.

9. The bill is burdensome for the Department of Revenue because amounts reported to the department must be reported on a separate form or on a separate line on the existing sales and use tax return, and programming must be done to make associated processing changes.

10. It would be less confusing for retailers for the effective date for the new 1% fee to be the first day of the calendar year that begins at least 60 days after publication or the first day of the calendar quarter that begins at least 60 days after publication. An effective date within the year or quarter would require special instructions for retailers filing returns covering periods both before and after the effective date.

Administrative Costs

The proposed legislation makes no provision for the funding of the costs involved in administering the activities required. To provide funding for the Department of Revenue's administrative costs under the bill, a new PR appropriation funded by a portion of the collections from the new fee could be created. If the author wishes to provide funding, appropriation language could be developed and costs allocated in the following manner:

	Chapter 20	**Amount**	**FTE**
one-time	s. 20.566 – new PR appropriation		
	Programming	$300,000	
	Revenue Agent LTE	$72,500	
	Printing and Postage	$56,300	
	Total Onetime	$428,800	
annual	s. 20.566 – new PR appropriation		
	Revenue Agent	$54,300	0.8
	Printing and Postage	$4,800	
	Total Annual	$59,100	

If you have any questions regarding this technical memo, please contact me at 266-5773.

cc: Representative Friske