Legislative Fiscal Bureau
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September 30, 2003

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 507: Sales Tax Exemption for Fuel and Electricity used in Manufacturing

Assembly Bill 507, relating to creating a sales tax exemption for fuel and electricity used in manufacturing, was introduced on September 11, 2003, and referred to the Assembly Committee on Economic Development and to the Joint Survey Committee on Tax Exemptions. The bill was withdrawn from the Assembly Committee on Economic Development and referred to the Joint Committee on Finance on September 18, 2003.

CURRENT LAW

Under current law, a credit against the state individual and corporate income and franchise taxes may be claimed for the amount of sales and use tax paid for fuel and electricity consumed in manufacturing in Wisconsin. The credit may not be claimed for heating, light, or other uses of energy that are not directly related to a manufacturing process. The manufacturer must allocate manufacturing use as a portion of total energy use for the purposes of computing the credit. If the credit exceeds tax liability for the year, it is not refundable but any unused portion may be carried forward up to 15 years to offset any future tax liability.

Corporations and owners, partners, shareholders, and members of businesses organized as sole proprietorships, partnerships, S corporations, and limited liability companies (LLCs) treated as partnerships can claim the credit. Partners, shareholders of S corporations, and members of LLCs claim the credit in proportion to their ownership interest. The credit can only be claimed against the tax imposed on the business operations of the claimant in which the fuel and electricity are consumed and, for partners, shareholders, and members, the credit can only be claimed against their pro-rated share of income.

Manufacturing is 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. Manufacturing includes the assembly of finished units of tangible personal property and packaging when: (a) it is part of an operation performed by the producer of the product or by another on the producer's behalf; and (b) the package or container becomes part of the tangible personal property as such unit is customarily offered for sale by the manufacturer. Manufacturing also includes: (a) conveyance of raw materials and supplies from plant inventory to the work point of the same plant; (b) conveyance of work in progress directly from one manufacturing operation to another in the same plant; and (c) conveyance of finished products to the point of first storage on the plant premises. It includes testing or inspection throughout the production cycle. Manufacturing does not include storage, delivery to or from the plant, repairing or maintaining facilities, or research and development.

SUMMARY OF BILL

Assembly Bill 507 would eliminate the tax credit, under the state individual and corporate income and franchise taxes, for sales taxes on fuel and electricity for tax years that began on or after December 31, 2004. However, tax credits claimed for tax years that begin before January 1, 2005, could be carried forward to offset future liabilities for tax years after December 31, 2004.

Assembly Bill 507 would also provide a sales tax exemption for the gross receipts from the sale of fuel and electricity sold for use in manufacturing tangible personal property in Wisconsin. This exemption would first apply to fuel and electricity sold on or after January 1, 2005

FISCAL EFFECT

Assembly Bill 507 would eliminate the manufacturers' sales tax credit, beginning with tax year 2005, and replace it with a sales tax exemption for fuel and electricity used in manufacturing.

The net fiscal effect of the proposed change would have three components: (a) an annual reduction in state and local sales tax revenues from providing an exemption for sales taxes paid for fuel and electricity used in manufacturing; (b) an annual increase in corporate income and franchise tax revenues equal to the amount of manufacturers' sales tax credits used to reduce tax liability in the current year; and (c) decreased corporate income and franchise tax revenues as unused credits are carried forward and used to offset future tax liabilities.

The Department of Revenue (DOR) estimates that, if the manufacturers' sales tax credit were replaced by a sales tax exemption, annual state sales tax collections would be reduced by $31 million. In addition, county, special district (baseball park), and professional football stadium district taxes would be reduced by a total of $2.25 million annually. However, not all credits claimed under current law are used to offset income and franchise tax liability in the year for which the credit is claimed. Consequently, it is estimated that eliminating the tax credit would increase annual corporate income and franchise taxes by $22 million annually.

The amount of unused manufacturers' sales tax credits carried forward from prior years for C corporations is estimated to be $155 million. These credits can be carried forward up to 15 years to offset future tax liabilities. The rate at which unused credits would be used depends upon the future corporate income and franchise tax liabilities of the corporations that could claim the unused credits.

Table 1 provides a summary of the estimate, developed by the Department of Revenue, of the annual fiscal effect of repealing the manufacturers' sales tax credit, providing a sales tax exemption for sales taxes on fuel and electricity used in manufacturing, and allowing the carry-forward of unused manufacturers' sales tax credits. The estimated use of unused credit carry-forwards is based on the current rate of use. In the first seven years that the credit was repealed and replaced with a sales tax exemption, it is estimated that annual state sales taxes would be reduced by $31 million. The estimated annual increase in corporate income and franchise tax revenues ($22 million) from repealing the tax credit would be entirely offset by unused carry-forwards. In the eighth year, the estimated reduction in state revenues would be $10 million, as the last of the unused carry-forwards were used. Once all unused carry-forwards were used up (year 9), the estimated annual ongoing fiscal effect would be a reduction in state tax revenues of $9 million (a $31 million reduction in state sales taxes and a $22 million increase in corporate income and franchise taxes).

TABLE 1

Estimated Fiscal Effect of Replacing the Manufacturing Sales Tax Credit with a Sales Tax Exemption and Allowing Credit Carry-Forwards ($ in Millions)

	(Years 1-7)	Year 8	Ongoing Year 9
Sales Tax Exemption	-$31	-$31	-$31
Repeal Manufacturers' Sales Tax Credit	22	22	22
Carry-Forward of Prior Year Credits	-22	-1	0
Net Fiscal Effect	-$31	-$10	-$9

Source: Department of Revenue

AB 507 would provide the sales tax exemption for fuel and electricity beginning on January 1, 2005, and continue to allow carry-forwards of unused manufacturers' sales tax credits from prior years. As a result, state sales tax revenues would be reduced by an estimated $15.5 million and local sales tax collections would be decreased by an estimated $1.1 million in 2004-05. The $31 million annual net state fiscal effect and $2.2 million local fiscal effect would begin in 2005-06.

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