



Legislative Fiscal Bureau

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June 12, 2019

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 251: Reducing Individual Income Tax Rates and Requiring Marketplace Providers to Collect Sales Tax

Assembly Bill 251 (AB 251) was introduced on May 31, 2019, and referred to the Assembly Committee on Ways and Means. On June 7, 2019, Assembly Substitute Amendment 1 (ASA 1) to AB 251 was introduced. The Assembly Ways and Means Committee held a public hearing on AB 251 on June 6, 2019, and on June 10, 2019, adopted ASA 1 and recommended the bill, as amended, for passage, by a vote of 7 to 4. AB 251, as amended, was referred to the Joint Committee on Finance on June 11, 2019.

Senate Bill 243 (SB 243) was introduced on May 24, 2019, and referred to the Senate Committee on Agriculture, Revenue, and Financial Institutions. Senate Substitute Amendment 1 (SSA 1) to SB 243 was introduced on June 10. SB 243 is identical to AB 251, and SSA 1 is identical to ASA 1.

BACKGROUND

Under the state individual income tax, state law establishes four tax brackets and assigns a marginal tax rate to each bracket. The brackets vary by filing status, and each tax bracket spans a range of taxable income. Each marginal tax rate applies only to income that falls within the corresponding bracket, and a taxpayer's gross tax is the cumulative total tax from each applicable bracket. The tax brackets are indexed annually for inflation. The following table reports the rate and bracket structure by filing status for tax year 2019.

Tax Rates and Brackets for Tax Year 2019

<u>Tax Rate</u>	<u>Married-Joint</u>	<u>Single or Head-of-Household</u>	<u>Married- Separate</u>
4.00%	Less than \$15,680	Less than \$11,760	Less than \$7,840
5.84	15,680 to 31,360	11,760 to 23,520	7,840 to 15,680
6.27	31,360 to 345,270	23,520 to 258,950	15,680 to 172,630
7.65	345,270 and over	258,950 and over	172,630 and over

Wisconsin imposes a general sales and use tax at a rate of five percent on the sales price or purchase price of taxable goods and services used and sold in this state. The sales tax is imposed on retailers for the privilege of making taxable sales in the state and is usually passed on by a retailer to its customers. The use tax is imposed as a complement to the sales tax to prevent consumers from avoiding tax by purchasing taxable goods in other states and to allow state merchants to compete on an equal basis with sellers in other states that have lower (or nonexistent) sales tax rates. A credit is allowed for sales tax properly paid in the other state. An enforceable use tax assures the equal taxation of all purchases by state residents and gives no competitive advantage to either resident or nonresident sellers.

Wisconsin is a member of the Streamlined Sales and Use Tax Agreement (SSUTA) and allows remote sellers to either register to collect and remit sales and use tax to the state using their own software system or remit tax through a certified service provider. Certified service providers maintain a database of taxable and nontaxable goods and services, as well as tax rates for each taxing jurisdiction within each member state. States are required under the SSUTA to monitor the database for accuracy regarding their respective taxing jurisdiction.

Under a provision created in 2013 Wisconsin Act 20, state law establishes procedures for reducing individual income tax rates if additional sales and use tax revenues result from any federal law that expands the state's ability to require out-of-state sellers to collect and remit tax on remote sales to Wisconsin residents. The statute has been amended on two occasions. In response to a June 21, 2018, U.S. Supreme Court decision, *South Dakota v. Wayfair, Inc.*, the Department of Revenue (DOR) began requiring remote sellers to collect and remit sales and use tax on sales of taxable products and services in Wisconsin as of October 1, 2018. For tax year 2019, the individual income tax rates reported in the preceding table will be proportionally reduced, so that the lower amount of individual income tax collections will be offset by the additional amount of state sales and use taxes realized from imposing the state sales and use tax as a result of *Wayfair* on certain remote sellers during the 12-month period between October 1, 2018, and September 30, 2019.

The Act 20 provision, as modified, establishes the following procedures for determining the individual income tax rate reductions. DOR is required to determine the amount of sales and use tax reported by out-of-state retailers for the designated 12-month period and the proportional individual income tax rate reductions. By October 20, 2019, the DOR Secretary is required to report those determinations to the Governor, the Secretary of the Department of Administration (DOA), the Joint Committee on Finance, and the Legislative Audit Bureau (LAB). The LAB is required to review the

DOR determinations and report its findings to the Joint Legislative Audit Committee and the Joint Committee on Finance by November 1, 2019. If the LAB review results in a different calculation of tax rates, the Joint Committee on Finance is required to determine which tax rates would go into effect for tax year 2019 and report that determination to the Governor, the Secretary of DOA, and the Secretary of DOR no later than November 10, 2019.

SUMMARY OF AB 251

Distribution Facility Exception. Under current law, a person is not required to collect and remit sales tax on sales made on behalf of third-party sellers if the person, or the person's affiliate: (a) operates a distribution facility where no retail sales take place; (b) discloses to the customer that the third-party is the seller and the third-party seller owns the goods being sold; and (c) makes no sales of goods for which the customer takes possession of the goods at a location operated by the person or any of the person's affiliates. DOR is not aware of any such persons currently operating in Wisconsin that are eligible for the distribution facility exception under current law. The bill would repeal this exception.

Marketplace Provisions. The bill would require a marketplace provider to collect and remit state sales or use tax on sales facilitated by the marketplace provider on behalf of a marketplace seller as follows.

Definition of Marketplace Provider and Marketplace Seller. The bill would define a marketplace provider to mean any person who facilitates a retail sale by a seller by listing or advertising taxable goods and services for sale by the seller, in any manner, and through agreements or arrangements with third parties, directly or indirectly, who are collecting payment from the purchaser and transmitting that payment to the seller, regardless of whether the person receives compensation or other consideration in exchange for the services provided by the person. A marketplace seller would mean a seller who sells products through a physical or electronic marketplace operated by a marketplace provider, regardless of whether the seller is required to be registered with DOR. For purposes of defining a marketplace provider or a marketplace seller, "products" would mean taxable goods and services.

In addition, the bill would add to the definition of a retailer a marketplace provider who facilitates, on behalf of a marketplace seller, taxable sales of goods and services that are sourced to Wisconsin. The bill would expand the definition of a retailer for purposes of sales tax collection to mean every seller who makes any sale of tangible personal property or services, regardless of whether the sale is made on the seller's own behalf or on behalf of another person (the bill would similarly modify the definitions of sale and seller under current law to clarify that the definitions apply regardless of whether the sale is made on the seller's own behalf or on behalf of another person). As a result, both marketplace providers and marketplace sellers could be regarded as retailers for purposes of the sales tax.

Liability of Marketplace Providers and Marketplace Sellers: Waiver Provisions. The bill would stipulate that, with limited exceptions, a marketplace provider is liable to collect and remit sales tax on sales made on behalf of a marketplace seller. However, a marketplace provider whose

only activities are facilitating sales of services on behalf of marketplace sellers operating under a shared hotel, motel, or restaurant brand name could submit an application to DOR to request a waiver from collecting and remitting tax on sales facilitated on behalf of marketplace sellers. The application would have to include the name and address of all marketplace sellers selling or furnishing such services in this state, the marketplace seller's sales or use tax permit number, and any other information DOR requires. DOR could grant the waiver if it is satisfied that the sales tax is collected and remitted by the marketplace sellers. A marketplace provider that is granted the waiver would have to provide the above information to DOR within 60 days from a written request by the Department.

The marketplace provider required to remit tax would be required to notify the marketplace seller that it will collect and remit the sales tax. If the marketplace provider gives such notification, only the marketplace provider could be audited and held liable for the tax. If no such notification is provided, however, both the marketplace provider and the marketplace seller could be audited and held liable for the tax. In addition, for each sale facilitated on behalf of a marketplace seller, the marketplace provider would be required to obtain and maintain each exemption certificate provided by a purchaser claiming an exemption from the tax. The sales price subject to tax would include the entire sales price charged to a purchaser, including any charges for facilitating the sale on the seller's behalf.

Liability Relief. Under the bill, if a marketplace provider is audited by DOR, the marketplace provider may obtain relief from liability determined in the audit if it could demonstrate to DOR's satisfaction that: (a) the sale was made solely on behalf of a marketplace seller; (b) the marketplace provider properly notified the marketplace seller as described above; and (c) the retail sale was properly sourced to Wisconsin (the sale took place in Wisconsin). In addition, the relief from liability could not exceed: (a) five percent of the total tax due for tax years 2019 and 2020; and (b) 3 percent of the total tax due for tax year 2021. The liability relief would no longer be provided beginning in tax year 2022.

In addition, the bill would specify that a marketplace provider is relieved of liability for the failure to collect and remit the correct amount of sales tax to the extent that the marketplace provider could demonstrate to DOR's satisfaction that the error is due to insufficient or incorrect information given to the provider by the marketplace seller. However, this would not apply if the marketplace provider and marketplace seller are "related entities," as defined under federal income tax law. Moreover, nothing in the bill would remove a purchaser's obligation to remit use tax for any transaction on which a marketplace provider or marketplace seller did not collect and remit the tax.

Prohibition on Class Action Lawsuits. Under the bill, no person could bring a class action against a marketplace provider in any court of this state on behalf of consumers arising from, or in any way related to, an overpayment of sales or use tax collected on sales facilitated by the marketplace provider, regardless of whether that claim is characterized as a claim for a refund.

Deductions. The bill would stipulate that a marketplace provider who collects and remits sales or use tax on behalf of a marketplace seller could claim a deduction for bad debts against their sales tax liability if either the marketplace provider or marketplace seller could claim a deduction for bad

debt under federal income tax law. A marketplace seller would not be allowed to claim such a deduction for the same transaction. A marketplace seller could claim a deduction on their sales tax return for the sales price of each sale for which the seller received notification from the marketplace provider that the latter would collect sales tax on the former's behalf.

Other Provisions. The bill would modify laws governing the room tax, the local rental car tax, the local food and beverage tax, and the state rental vehicle fee to conform to this provision, so that the responsibility for tax collection and remittance is with the same person for each tax or fee. These provisions would take effect on the first day of the calendar quarter that is at least three months after publication of the bill.

Individual Income Tax Rates. The bill would modify the Act 20 individual income tax rate reduction provision in two ways. First, the bill would extend the 2019 tax year reductions on an ongoing basis. Second, the bill would repeat the tax rate reduction procedure for tax year 2020 based largely on the sales and use tax collections attributable to the marketplace provider provision.

At the time the individual income tax rate reduction statute was amended the second time, the amended provision was expected to reduce the tax rates on an ongoing basis, beginning in tax year 2019. However, the amended statute reads, "the new tax rates take effect for the taxable year ending on December 31, 2019" and "apply to the taxable year ending on December 31, 2019." After reviewing the amended language, DOR has indicated that it interprets the law to mean the income tax rate reduction applies to tax year 2019 only. The bill would amend the tax rate reduction provision by extending the tax year 2019 rates on an ongoing basis.

The bill would create a second tax rate reduction procedure based largely on the amount of sales and use tax collections attributable to the marketplace provider provisions described above. For the period beginning on October 1, 2019, and ending on September 30, 2020, DOR would be required to determine the amount of additional sales and use tax revenue reported to the Department as a result of the Supreme Court decision expanding the state's authority to require out-of-state retailers and marketplace providers to collect and remit sales and use taxes on purchases by Wisconsin residents. Based on its determination of additional tax, DOR would be required to determine how much the tax rate for the second tax bracket could be reduced, so that the additional sales and use tax revenue would be offset by a reduction in individual income tax collections.

The bill would require the DOR Secretary to certify and report the additional sales and use tax determination and the individual income tax rate reduction to the Governor, the DOA Secretary, the Joint Committee on Finance, and the LAB by October 20, 2020. The tax rate reduction would take effect for tax year 2020 and extend to future tax years, as well. The LAB would be required to review the DOR determinations and report its findings to the Joint Legislative Audit Committee and the Joint Committee on Finance by November 1, 2020. If the LAB review results in a different calculation of tax rates, the Joint Committee on Finance would be required to determine which tax rates would go into effect for tax year 2020 and report that determination to the Governor, the Secretary of DOA, and the Secretary of DOR no later than November 10, 2020.

ASA 1 TO AB 251

ASA 1 would make the following changes to AB 251.

The definition of a marketplace provider would not include a person who provides advertising services or product listings and who neither collects payment from the purchaser nor remits such payment to the marketplace seller. The substitute amendment would not specify that a "product" is defined to include taxable goods and services for purposes of defining a marketplace provider. The amendment would also provide that a marketplace seller could be audited and held liable to collect and remit tax on sales for which the seller provided insufficient or incorrect information to the marketplace provider.

The substitute amendment would remove the liability relief described above (5 percent of the total tax due in tax years 2019 and 2020, and 3 percent in 2021). A technical amendment would be necessary to accomplish the author's intent.

In addition, the substitute amendment would expand the bill's waiver provisions to allow DOR to grant waivers for other types of marketplace providers if there is evidence that the associated marketplace sellers have a history of reliably collecting and remitting sales tax to the Department, or if there is other evidence that the marketplace sellers will reliably collect and remit the tax. The waiver would extend to marketplace providers that facilitate sales of tangible personal property and certain taxable services, rather than only taxable services. Finally, the substitute amendment would delete the provision relating to the prohibition of class action lawsuits brought against a marketplace provider.

The substitute amendment would modify the bill's individual income tax provisions in three ways. First, the 2019 tax rate reduction would target the tax rate for the second tax bracket (currently, 5.84%), replacing the current across-the-board tax rate reduction under which each of the four tax rates would be reduced in proportion to its share of gross taxes. Second, the 2019 tax rate reduction would not be made ongoing, so the new rate for the second tax bracket would apply only in tax year 2019. Finally, the tax rate reduction taking effect in tax year 2020 would be based on estimated sales and use tax collections between October 1, 2019 and September 30, 2020, both from remote sellers and from marketplace providers. As under the original bill, the rate reduction would target the tax rate for the second tax bracket and the tax rate reduction would be ongoing and apply to future tax years.

FISCAL EFFECT OF ASA 1

As noted, the sales tax provisions affecting marketplace providers would take effect on the first day of the calendar quarter that is at least three months after publication. Assuming these provisions take effect on October 1, 2019, it is estimated the provisions will increase state sales and use tax collections by \$50,300,000 in 2019-20 and by \$67,100,000 in 2020-21.

The income tax rate reduction for the second income tax bracket for tax year 2019 is estimated at \$61,000,000. Because a reduction of the same magnitude is already authorized under current law,

the modification under the substitute amendment does not have a fiscal effect. The income tax rate reduction that would take effect in tax year 2020 is estimated at \$136,100,000 [an amendment would be necessary to clarify the rate reduction]. The reduction would be based on estimated sales and use tax collections between October 1, 2019, and September 30, 2020, of \$69,000,000 from remote sellers and \$67,100,000 from marketplace providers. Because the new tax rate would not be known until late in the tax year, the entire individual income tax reduction would occur in 2020-21.

The combined effect of the sales and use tax and individual income tax modifications on general fund tax collections is estimated to increase revenues by \$50,300,000 in 2019-20 and decrease revenues by \$69,000,000 in 2020-21 (net revenue reduction of \$18,700,000 for the 2019-21 biennium).

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