



Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873
Email: fiscal.bureau@legis.wisconsin.gov • Website: <http://legis.wisconsin.gov/lfb>

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Joint Committee on Finance

Paper #312

Retailer's Sale of Prepared Food (General Fund Taxes -- Sales and Excise Taxes)

[LFB 2017-19 Budget Summary: Page 193, #4]

CURRENT LAW

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 sold or used in this state, with certain exceptions. Sales of food and food ingredients are generally exempt from the tax. However, this exemption does not apply to candy, soft drinks, dietary supplements, or prepared food.

Under current law, "food and food ingredient" is a substance sold for ingestion or chewing by humans for its nutritional value. As a result, if a retailer were to sell a frozen pizza made by a supplier, the frozen pizza would be exempt from sales tax as food. However, the definition of "prepared food" specifically includes two or more food ingredients that are mixed or combined by a retailer for sale as a single item, with certain exceptions. Therefore, if a retailer were to sell a frozen or uncooked pizza, which the retailer had assembled for purchase by the consumer, that frozen or uncooked pizza would be subject to tax provided that it: (a) did not contain any raw eggs, fish, meat, or poultry that require cooking by the consumer, as recommend by the federal Food and Drug Administration to prevent food-borne illness; and (b) was not sold by volume or weight as a single, unheated item.

GOVERNOR

The bill would create an exemption from the general sales and use tax for prepared food that is sold by a retailer and: (a) manufactured by the retailer in a building assessed as manufacturing property (or would be if it were located in this state); (b) the retailer makes no retail sales of prepared food at this building; (c) the retailer freezes the prepared food prior to its

sale; (d) the retailer sells the prepared food in its frozen state; (e) the prepared food is not sold with eating utensils; and (f) the prepared food is not candy, soft drinks, or dietary supplements. As a result, frozen food sold by a retailer would be treated similarly regardless of whether the food was prepared by that retailer offsite (currently taxable as prepared food) or prepared by another person (currently exempt as a food).

DISCUSSION POINTS

1. Exemptions from the general sales and use tax narrow the tax base (which puts a greater burden on the purchasers of goods remaining taxable), impede economic efficiency, create inequities between types of businesses, and complicate administration and compliance of the tax.

2. On the other hand, when enacted in the context of a generally broad-based sales tax, exemptions can be used selectively to lessen the regressivity of the tax.

3. A strong case for an exemption can be made for food for home consumption. Because lower-income families typically consume a larger portion of their incomes on food than middle- and higher- income families, the burden of a sales tax on food will fall more heavily on lower-income families. If food is exempt from an otherwise general sales tax, the tax tends to become proportional over the middle range of income levels, although remaining regressive as to the highest and lowest income levels.

4. Of the 45 states with a general sales tax, 32 provide an exemption for food for home consumption. Six states tax food at a rate lower than for other goods and an additional five states provide some sort of tax credit or rebate to offset the sales tax on food.

5. By contrast, purchases of food prepared for immediate consumption are generally subject to sales tax in all states having a general sales tax. The difference in treatment stems in part from food being identified as a basic necessity of life which all families must purchase, whereas meals prepared in restaurants are not.

6. Current law provides for incongruent tax treatment of vertically integrated retailers of certain food items. For example, frozen pizza manufactured by a supplier is nontaxable food when sold by a retailer, but that same frozen pizza would be taxable as prepared food if manufactured offsite by the retailer.

7. The administration indicates that the differing sales tax treatment of frozen food prepared offsite by retailers discourages vertical integration in food manufacturing and disadvantages retailers who prepare their own brands of frozen food items.

8. Further, it could be argued that current law runs counter to the rationale for exempting food purchases from the sales tax. In such cases the retailer is selling food for home preparation and consumption. The retailer is not selling a meal to a consumer for immediate consumption.

9. It is likely that many families purchase frozen food items prepared offsite by retailers without knowing that such items are taxable. The proposed exemption could offer modest tax relief

for families purchasing certain frozen foods.

10. Assuming an effective date of July 1, 2017, the administration estimates that the exemption would decrease tax revenue by \$1,000,000 annually. The estimate is based upon data from the 2012 economic census by the U.S. Census Bureau regarding taxable sales at convenience stores and grocery stores.

11. The administration's estimate appears to be reasonable given recent trends in U.S. sales of food services and food for consumption off premises, as estimated by IHS Markit (formerly IHS Global Insight). It is reasonable to anticipate that grocers, convenience stores, and some restaurants would be among the beneficiaries of the proposed exemption, since such retailers are likely to prepare their own food items at offsite locations.

12. The Department of Revenue indicates that the proposed exemption for prepared food would comply with the Streamlined Sales and Use Tax Agreement, which requires member states such as Wisconsin to utilize common definitions for certain defined terms.

13. The Committee may wish to approve the Governor's recommendation (Alternative 1). The proposed exemption would provide similar tax treatment for frozen foods made offsite by retailers and frozen food purchased by retailers for resale from suppliers. Further, the proposed exemption may provide tax relief to families purchasing such frozen foods.

14. However, the Governor's recommendation would continue to treat raw and frozen food prepared by retailers differently. For example, a raw pizza assembled by employees at the retailer's location, such as a take-and-bake pizza, is taxable as a prepared food item whereas a frozen pizza assembled offsite would be exempt.

15. Arguably, the rationales put forward by the administration for the proposed exemption would equally apply to all prepared foods requiring cooking by the consumer prior to consumption.

16. The Committee may wish to expand the proposed exemption to include all food sold that ordinarily requires additional cooking, as opposed to just reheating, by the consumer prior to consumption (Alternative 2). This would provide similar treatment for food items created by retailers, regardless of whether such items are frozen or prepared offsite at a manufacturing facility. This would apply to "take and bake" raw grocery food products generally, such as pizza and baked goods. It is estimated that this alternative would decrease revenues by \$4.5 million annually.

17. Finally, the Committee may decide that current law adequately provides sales tax exemptions for food purchases and that it is not necessary to create a new exemption for retailers preparing food off premises. The Committee may therefore wish to deny the governor's recommendation, avoiding an estimated loss of tax revenues of \$1,000,000 annually (Alternative 3).

ALTERNATIVES

1. Approve the Governor's recommendation.

ALT 1	Change to	
	Base	Bill
GPR-Tax	- \$2,000,000	\$0

2. Modify the Governor's recommendation to provide an exemption to the sales and use tax for all food sold that ordinarily requires additional cooking, as opposed to just reheating, by the consumer prior to consumption.

ALT 2	Change to	
	Base	Bill
GPR-Tax	- \$11,000,000	- \$9,000,000

3. Delete provision.

ALT 3	Change to	
	Base	Bill
GPR-Tax	\$0	\$2,000,000

Prepared by: John D. Gentry