



Legislative Fiscal Bureau

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Joint Committee on Finance

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Sales and Use Tax Exemption for Diapers (General Fund Taxes -- Sales and Use Taxes)

[LFB 2021-23 Budget Summary: Page 217, #2]

CURRENT LAW

Wisconsin imposes a general sales and use tax at a rate of 5% on the sales price or purchase price of taxable goods and services sold or used in this state, with certain exceptions. Under current law, sales of clothing, including sales of diapers, are currently subject to the sales and use tax.

BACKGROUND

The Streamlined Sales and Use Tax Agreement (SSUTA) was the product of a multi-state effort to simplify and modernize sales and use tax administration among the states, so that sellers that are not required to collect tax under federal law would voluntarily agree to collect and remit the tax for member states. Various members of the business community were involved with states in forming this Agreement. Wisconsin became a SSUTA member state on October 1, 2009, which requires some uniformity in tax administration among member states. More than 8,000 voluntarily sellers were remitting sales tax returns to Wisconsin under the Agreement as of April 23, 2021.

SSUTA ensures uniformity of major tax base definitions by requiring member states to adopt the definitions established by the Agreement. SSUTA defines "clothing" as all human wearing apparel suitable for general use. The definition includes a non-exhaustive list of items that would be classified as clothing, including "diapers, children and adult, including disposable diapers." A diaper is defined as an absorbent garment worn by humans who are incapable of, or have difficulty, controlling their bladder or bowel movements. Under SSUTA, the definition of diapers include both cloth and disposable diapers.

DISCUSSION POINTS

1. As a member state of SSUTA, Wisconsin is required to adopt the Agreement's definition of clothing and apply the same tax treatment to all items that fall within the definition. However, a 2018 amendment to the definition allows member states to exclude diapers from the definition of clothing, and to limit the exclusion to children's diapers or adult diapers (or both), if the state chooses to do so. Therefore, Wisconsin can provide an exemption for diapers, even though clothing generally remains subject to the sales and use tax.

2. State law already provides some sales tax relief related to diapers. While laundry, dry cleaning, pressing, and dyeing services are specifically subject to the sales and use tax, such services, if performed on cloth diapers by a diaper service, are exempt from the tax.

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

4. Proponents of a sales tax exemption for children's diapers argue that such products are a necessity for families with young children. According to the National Diaper Bank Network (NDBN), young children need at least 200 diaper changes per month. This amount is often higher for newborns, but declines as children get older. For families who cannot afford to purchase the necessary amount of diapers, the economic cost (and health cost) to the family is greater than just the cost of the diapers themselves. Without an adequate supply of diapers, infants are likely to spend more time in soiled diapers, which can lead to various illnesses, such as urinary tract infections and rashes. Additionally, most childcare facilities require parents to provide diapers for their child. NDBN states that 57% of parents experiencing diaper need, who rely on child care, missed an average of four days of school or work in the past month because they did not have diapers. This could result in foregone family income or falling behind in the individual's school work.

5. The average price of a diaper can range from 20¢ to 30¢. It should be noted that diaper prices can vary greatly depending on several factors. Brand name and premium diapers are generally the most expensive, and can be priced upwards of 40¢ per diaper. In contrast, some store brand diapers can be purchased for as low as 9¢ per diaper. Parents who utilize discounts and sales can also secure a lower price on diapers. In general, smaller diaper sizes are cheaper than larger sizes. This means that as children grow, parents spend more money per diaper, on average. However, older children typically need fewer daily diaper changes, so these differences largely offset each other and result in an average annual cost that is fairly equal throughout a child's first two years of life. Additionally, diapers are often cheaper when purchased in bulk. However, buying in bulk could mean that an infant grows out of a diaper size before all of the diapers of that size have been used.

6. For much of this paper, an average retail diaper price of 25¢ is assumed. Based on this price and the assumption that the average young child needs about 200 diaper changes per month, the average family spends around \$600 in diapers per year, before sales tax. Wisconsin families spend an additional \$30 per year, on average, in state sales tax on diapers. For families in the 68 counties that

impose a county sales tax, total sales tax amounts are estimated to be \$33 annually.

7. A sales tax exemption for children's diapers could make these products affordable for low-income families. If diapers were exempt from the state's 5% sales tax, families that cannot afford a sufficient diaper supply could afford to buy 5% more diapers with the money that would otherwise have been spent on tax. For example, a family who could only afford to purchase 180 diapers subject to sales tax would be able to purchase nine additional diapers with that tax savings if diaper sales were exempt from tax. Therefore, exempting diapers from the sales tax could help low-income families purchase (closer to) the necessary amount of diapers each month, or could free up money for other essential purchases.

8. However, opponents of providing a sales tax exemption for diapers argue that exemptions for "necessities of life" purchases are often poorly targeted and provide considerable tax breaks for those who do not need them. Such individuals note that eliminating the sales tax on diapers and other necessities does not address all financial assistance needs. A 2010 study by Huggies Every Little Bottom reported that mothers who experienced diaper need tended to be short 11 to 12 diapers each week. While a sales tax exemption could reduce these numbers, it would not eliminate the problem for those most in need. As long as diaper need still exists, the potential for increased infant illness, and parents missing days of work or school due to lack of childcare, would still exist.

9. As noted previously, brand name and premium diapers can be priced upwards of 40¢ per diaper, while some store brand diapers can be purchased for as low as 9¢ per diaper. On average, an individual who purchases premium diapers would pay \$48 per year in state sales tax, whereas an individual who purchases store brand diapers would pay less than \$11 per year in tax. A sales tax exemption for diapers would result in more than four times the tax savings for an individual purchasing only premium diapers relative to a more cost-conscious consumer that purchased only store brand diapers.

10. Currently, 11 states provide a sales tax exemption for diapers and an additional five states do not impose a statewide sales tax on any items. However, of the 11 states with an exemption for diapers, Maryland and North Dakota only provide a sales tax exemption for adult incontinence products.

11. Under Assembly Bill 68/Senate Bill 111, the Governor recommended providing an exemption from the general sales and use tax for sales of children's diapers. "Children's diapers" would mean diapers marketed to be worn by children. It is estimated that a sales and use tax exemption for children's diapers would reduce sales and use tax revenues by \$4,500,000 in 2021-22 and \$6,000,000 in 2022-23, and annually thereafter. This estimate is lower than the estimate provided by the administration, in part, because the administration's estimate included sales tax on adult diapers.

12. The administration indicates that the reason for excluding adult undergarments for incontinence (adult diapers) is that other provisions included in the Governor's budget are intended to provide relief to a similar demographic of individuals, including: (a) creation of a nonrefundable family caregiver income tax credit for individuals caring for family members age 18 or older; (b) provisions to reduce the cost of prescription drugs; and (c) provisions to improve Wisconsin's long-term care infrastructure.

13. However, some adults may need to wear undergarments for incontinence for various reasons, including incontinence or mental/physical impairments. State law allows various medical supplies to assist individuals who are impaired to be sold exempt from the sales tax. One could argue that adult diapers are similar to other medical supplies to assist these individuals and that it may be appropriate to treat these products similarly for sales tax purposes. If the Committee considers adult diapers to be a necessity, similar to children's diapers, it could consider expanding this sales and use tax exemption to adult diapers, which would result in an additional reduction in revenue of \$1,700,000 in 2021-22 and \$2,300,000 in 2022-23 (Alternative 2).

14. Various alternatives to a sales tax exemption for children's diapers are often proposed. Two such alternatives, offering a refundable income tax credit to families with young children, and providing assistance to diaper banks, are presented below.

15. As an alternative to creating a sales and use tax exemption for children's diapers, the Committee could create a \$30 refundable income tax credit for families with children under the age of three. Although a different credit amount could be selected, \$30 reflects the approximate amount families pay in state sales tax on diaper purchases annually, and could be provided for each dependent under age three. The Committee could choose to provide this credit to all Wisconsin families with young children, or restrict this credit to low-income families. If provided to all families with children under three, the cost of the credit would be \$5,200,000 annually (Alternative 3a). If the \$30 credit was limited to families with Wisconsin adjusted gross income (WAGI) under 200% of the federal poverty level, and the credit amount phased out for individuals earning between 200% and 300% of the federal poverty line, the estimated cost of the credit would be \$2,800,000 annually (Alternative 3b). If the Committee chose to limit the \$30 credit to families with WAGI under the federal poverty level, and phased out the credit for individuals earning between 100% and 200% of the federal poverty line, the annual cost of the credit would be \$1,700,000 (Alternative 3c). These estimates were derived from a DOR simulation of individual income tax filers for tax year 2021.

16. However, one concern with providing a refundable income tax credit is that, unlike a sales tax exemption, credits do not provide immediate relief. Families would have to wait until they file their income taxes to benefit from the credit. Additionally, like sales and use tax exemptions, income tax credits add complexity to the tax code. Further, the refundable credit would only benefit families that file an income tax return.

17. The National Diaper Bank Network is a non-profit organization that focuses on ensuring that all children in the U.S. have an adequate supply of diapers to remain clean, dry, and healthy. A large portion of the organization's work is done through partnerships with its member banks. There are currently 10 NDBN-member diaper banks located throughout the state of Wisconsin. It should be noted that many diaper banks do not provide diapers directly to families, but instead distribute their supply to various local partner agencies. These agencies often require families to pick up diapers at a physical location, but some deliver directly to families. NDBN reported that Wisconsin diaper banks distributed more than 1.8 million diapers in 2020. As noted, families who are unable to purchase a sufficient supply of diapers are short, on average, 50 diapers per month, or 600 diapers per year (approximately 25% of diapers needed per child per year). Based on this figure, NDBN estimates that Wisconsin diaper banks are able to help 3,072 infants and toddlers monthly. However, based on data

reported by NDBN and Kids Count Data Center, it is estimated that all Wisconsin children in families earning below the federal poverty level would need a total of approximately 17.7 million diapers per year. To meet the diaper need for all Wisconsin children in families earning below 200% of the federal poverty line, it is estimated that approximately 44.7 million diapers would be needed per year.

18. Currently, diaper banks rely largely on donations of diapers and funds by individuals and organizations, collections from hosting diaper drives, and its own funds to purchase and supply diapers to families in need. The Committee could choose to provide not-for-profit diaper banks with additional diapers, or provide funding for the diaper banks to make bulk diaper purchases, to assist low-income families to meet their diaper needs. The total cost of diapers (not including the cost of distribution) to provide an additional 15.9 million diapers for families earning below the federal poverty level would be \$2.4 million, assuming that diapers can be purchased in bulk at a cost of 15¢ per diaper. Instead of providing a sales and use tax exemption for diapers, which would only address a small portion of the financial need for low-income families, the Committee could consider creating a grant program, administered by DOR, to provide assistance to Wisconsin diaper banks (Alternative 4). The Committee could choose to provide \$2,400,000 annually to the program to assist Wisconsin diaper banks in providing diapers to children in families earning less than the federal poverty level (Alternative 4a). Likewise, approximately 42.9 million additional diapers would be needed to meet the diaper need for all families earning less than 200% of the federal poverty level. The Committee could consider providing \$6,500,000 annually to provide diapers for all low-income families with young children (Alternative 4b). Although DOR is presented as the agency to administer the grant program under this alternative, the Committee could choose any agency it believes is best suited to administer the program.

19. If the Committee chooses to create a grant program, administered by DOR, to distribute diapers and/or funds to Wisconsin diaper banks, it could require that, prior to making a grant, the Department submit to the Joint Committee on Finance a plan for implementing the program, including associated costs to administer the program. After receiving the plan, the Co-chairpersons of the Committee could either: (a) direct DOR to implement the plan; or (b) convene a meeting of the Committee within 14 days after the plan is submitted to approve, or modify and approve, the plan. The Department would have to implement the plan, as approved by the Committee.

20. Unlike a sales tax exemption for diapers, in which all families would benefit whether they are aware of the exemption or not, or a refundable credit that families would claim when filing their annual income tax return, a grant program to assist Wisconsin diaper banks would only benefit families to the extent that they are aware of, and choose to utilize, the program. Additionally, as there are only 10 diaper banks currently located in Wisconsin, some families, particularly in rural areas, may not have access to the assistance that diaper banks provide. However, the expanded amount of diapers and/or funding to Wisconsin diaper banks may enable further expansion of the existing diaper bank network. In addition, diaper banks partner with food pantries and other local agencies which may better serve more rural areas.

21. Alternatively, the Committee could choose to take no action on this proposal (Alternative 5). It should be noted that 2021 Senate Bill 227, which has bipartisan sponsorship, proposes a broader sales and use tax exemption for children's diapers, undergarments for incontinence

(adult diapers), tampons, and sanitary napkins. If the Committee chose to take no action, the Legislature could address this issue outside of the budget process.

ALTERNATIVES

1. Provide a sales and use tax exemption for sales of children's diapers. Define "diaper" as an absorbent garment worn by individuals who are incapable of, or have difficulty, controlling their bladder or bowel movements. Specify that "children's diapers" means diapers marketed to be worn by children. Specify that the provision takes effect on the first day of the third month beginning after publication of the bill. Estimate a reduction in state tax revenues of \$4,500,000 in 2021-22 and \$6,000,000 in 2022-23 and annually thereafter.

ALT 1	Change to Base
GPR-Tax	- \$10,500,000

2. Provide a sales and use tax exemption for sales of all diapers, including both children's diapers and adult diapers. Define "diaper" as an absorbent garment worn by individuals who are incapable of, or have difficulty, controlling their bladder or bowel movements. Specify that the provision takes effect on the first day of the third month beginning after publication of the bill. Estimate a reduction in state tax revenues of \$6,200,000 in 2021-22 and \$8,300,000 in 2022-23 and annually thereafter.

ALT 2	Change to Base
GPR-Tax	- \$14,500,000

3. Provide a refundable income tax credit of \$30, beginning in tax year 2021, for each child under the age of three. Create a sum sufficient GPR appropriation to pay credit claims. Specify that no credit would be allowed unless it is claimed within four years of the unextended due date of the income tax return to which the claim relates. Prohibit nonresidents and part-year residents of Wisconsin from claiming the credit. Direct that no credit could be allowed for a tax year covering a period of less than 12 months, except for a tax year that was closed because of the death of the taxpayer. Specify that current law provisions that apply to the individual income tax relating to DOR's enforcement authority, and to assessments, refunds, appeals, collection, interest, and penalties, also apply to this credit. Require couples who are married at the end of a tax year to claim the credit as married-joint filers for that tax year, except permit married persons living apart and treated as single under the Internal Revenue Code to claim the credit as if a single or head-of-household claimant.

a. Specify that the credit is made available to all claimants with children under age three, regardless of their WAGI. Increase estimated GPR expenditures by \$5,200,000 annually, beginning in 2021-22.

ALT 3a	Change to Base
GPR	\$10,400,000

b. Specify that the \$30 credit is made available to claimants with WAGI below 200% of the federal poverty level. Specify that the credit amount is phased out proportionately for individuals earning between 200% and 300% of the federal poverty level. Increase estimated GPR expenditures by \$2,800,000 annually, beginning in 2021-22.

ALT 3b	Change to Base
GPR	\$5,600,000

c. Specify that the \$30 credit is made available to claimants with WAGI below 100% of the federal poverty level. Specify that the credit amount is phased out proportionately for individuals earning between 100% and 200% of the federal poverty level. Increase estimated GPR expenditures by \$1,700,000 annually, beginning in 2021-22.

ALT 3c	Change to Base
GPR	\$3,400,000

4. Create a GPR appropriation under DOR to provide assistance to diaper banks in Wisconsin and to pay costs incurred by the Department to administer the program. Require DOR to submit to the Joint Committee on Finance a plan for implementing the program, including associated administrative costs, prior to paying expenditures from this appropriation. After receiving the plan, the Co-chairpersons of the Committee must: (a) direct DOR to implement the plan; or (b) convene a meeting of the Committee within 14 days after the plan is submitted to approve, or modify and approve, the plan. The Department must implement the plan, as approved by the Committee.

a. Provide \$2,400,000 annually to aid diaper banks, primarily to meet the diaper need for children in families earning less than the federal poverty level.

ALT 4a	Change to Base
GPR	\$4,800,000

b. Provide \$6,500,000 annually to aid diaper banks, primarily to meet the diaper need for children in families earning less than 200% of the federal poverty level.

ALT 4b	Change to Base
GPR	\$13,000,000

5. Take no action.

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