

General Fund Taxes

Sales and Use Taxes

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Joint Committee on Finance

Paper #320

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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June, 2021

Joint Committee on Finance

Paper #321

Sales Tax Exemption for Sweetened Dried Fruit (General Fund Taxes -- Sales and Use Taxes)

[LFB 2021-23 Budget Summary: Page 218, #4]

CURRENT LAW

Under current law, sales of food and food ingredients, except candy, soft drinks, dietary supplements, and prepared food, are exempt from the sales tax. Fruit is included in the definition of food and food ingredients. However, sales of dried or partially dried fruits are taxed as candy if the dried fruit contains sugar or natural or artificial sweetener. Candy is defined as a preparation of sugar, honey, or other natural or artificial sweetener combined with chocolate, fruit, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. Candy does not include a preparation that contains flour or that requires refrigeration.

Effective October 1, 2009, Wisconsin entered the Streamlined Sales and Use Tax Agreement (SSUTA), which requires some uniformity in tax administration among member states. The Agreement focuses on improving sales and use tax administration systems for all sellers and all types of commerce through uniformity of major tax base definitions and simplified administration of exemptions, among other provisions.

DISCUSSION POINTS

1. In the fall of 2020, the Wisconsin State Cranberry Growers Association contacted the Department of Revenue (DOR) about creating a sales tax exemption for sweetened dried cranberries. Cranberries are a naturally tart fruit that are typically sweetened with sugar or artificial sweeteners. As a result, dried cranberries that are sweetened are treated as candy for sales tax purposes, while comparable dried fruits, such as naturally sweet raisins, are exempt from the sales tax. The administration states that providing an exemption for dried cranberries and other sweetened dried fruits would serve to treat all dried fruits similarly for tax purposes.

2. As a member of SSUTA, Wisconsin is required to utilize common definitions for certain defined terms, such as food and candy. Member states must treat all items that fall under a certain defined term the same for sales and use tax purposes. Therefore, under Wisconsin's current law definition of candy, the state could not provide an exemption for sweetened dried fruit without also providing an exemption for all other candy. To address this, DOR filed a motion to SSUTA to amend the Agreement. This motion was approved and the Agreement was amended in December, 2020.

3. The amendment gives member states the choice of excluding sweetened dried fruit from the definition of candy. Specifically, member states now have the option of specifying that candy would not include a preparation that has as its predominant ingredient dried or partially dried fruit, along with one or more sweeteners, and which may also contain other additives, including oils, natural flavorings, fiber, or preservatives. Under this specification, dried or partially dried fruits prepared with the following would not be excluded from the definition of candy: (a) chocolate; (b) nuts; (c) yogurt; or (d) a confectionary coating or glazing. Additionally, dried or partially dried fruit would not include fruit that has been ground, crushed, grated, flaked, pureed, or jellied.

4. The Governor recommends providing a sales and use tax exemption for sweetened dried fruit, which is currently defined as candy and subject to tax. To accomplish this, the state could adopt the SSUTA exclusion to the definition of candy. The administration estimates that this exemption would decrease state tax revenues by \$400,000 in 2021-22 and \$500,000 in 2022-23 and annually thereafter.

5. 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. Sales and use tax theory generally recommends imposing the tax on a broad base to keep the sales tax at a low rate. For example, in 2019-20, Wisconsin collected \$5.84 billion in sales and use tax revenue. In its 2021-23 Summary of Tax Exemption Devices publication, DOR estimates that the existing sales and use tax exemption for food and food ingredients, including bottled water, resulted in \$705.7 million in foregone sales tax revenue in 2019-20. If the state had eliminated the exemption for these products, the sales and use tax rate could have been reduced from 5.0% to 4.5%, while still generating a similar amount of revenue in 2019-20.

6. 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. The sales tax has generally been thought to be inherently regressive because the proportion of an individual's or family's income devoted to consumption declines as income increases. Persons at lower income levels, therefore, tend to pay a larger share of their income in sales tax.

7. A strong case can be made for an expansion of the exemption for food for home consumption. Because lower-income families typically consume a larger portion of their incomes on necessities such as food than middle- and higher- income families, the burden of a sales tax on food will fall more heavily on lower-income families. According to the Bureau of Labor Statistic's 2019 Consumer Expenditures report, consumers in the lowest income quintile spent an average of 23% of their income on food for home consumption, while consumers in the highest income quintile spent only 3.3% of their income on food for home consumption. If food is exempt from an otherwise general sales tax, the tax tends to become less regressive.

8. In general, dried cranberries are a good source of fiber and antioxidants, which can benefit an individual's immune system, metabolism, and heart. However, the drying of cranberries increases its make-up of carbs and sugar, compared to raw cranberries, even before any added sweeteners. Most dried cranberries contain added sweeteners as well. The Committee could consider whether the nutritional make-up of sweetened dried fruits, such as dried cranberries, are more comparable to other unsweetened dried fruits, or if they are more comparable to candy.

9. The Committee could provide a sales tax exemption for sweetened dried fruit (Alternative 1). This would provide consistent tax treatment for all dried fruit, regardless of whether they are sweetened or not. Alternatively, the Committee could choose not to expand the sales and use tax exemption for food to include sweetened dried fruit (Alternative 2).

ALTERNATIVES

1. Provide a sales and use tax exemption for sales of sweetened dried or partially dried fruit. Specify that candy does not include a preparation that has as its predominant ingredient dried or partially dried fruit along with one or more sweeteners, and which may also contain other additives, including oils, natural flavorings, fiber, or preservatives. Specify that a preparation that includes chocolate, nuts, yogurt, or a preparation that has a confectionary coating or glazing on the dried or partially dried fruit is candy. Specify that dried or partially dried fruit does not include fruit that has been ground, crushed, grated, flaked, pureed, or jellied. 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 \$400,000 in 2021-22 and \$500,000 in 2022-23.

ALT 1	Change to Base
GPR-Tax	- \$900,000

2. Take no action.

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June, 2021

Joint Committee on Finance

Paper #322

Sales Tax Exemption for Energy Systems and Prairie or Wetland Planning Services (General Fund Taxes -- Sales and Use Taxes)

[LFB 2021-23 Budget Summary: Page 217, #3, and Page 219, #5]

CURRENT LAW

Current law provides an exemption from the state sales and use tax for a product that has as its power source wind energy, direct radiant energy received from the sun, or gas generated from anaerobic digestion of animal manure and other agricultural waste, if the product produces at least 200 watts of alternating current or 600 British thermal units per day. The exemption also applies to the sale of electricity or energy produced by these products, but does not apply to an uninterruptible power source that is designed primarily for computers. In its 2021-23 Summary of Tax Exemption Devices publication, the Department of Revenue (DOR) estimates that this exemption resulted in \$106,000 in foregone sales and use tax revenue in 2019-20.

Additionally, under current law, all services are exempt from the state sales and use tax unless specifically made taxable by statute. State law specifies that the sale of landscaping and lawn maintenance services is taxable, including: (a) landscape planning and counseling; (b) lawn and garden services, such as planting, mowing, spraying, and fertilizing; and (c) shrub and tree services.

DISCUSSION POINTS

1. The following sections describe various sales tax exemptions and modifications proposed by the Governor under Assembly Bill 68/Senate Bill 111 (AB 68/SB 111), which include: (a) providing an exemption for products used to store certain types of renewable energy; (b) modifying the language of the current law exemption for energy systems; and (c) providing an exemption for planning and counseling services related to prairie, wetland, or savanna restoration.

2. The administration indicates that these exemptions are consistent with the policy recommendations of the Governor's Task Force on Climate Change, which include: (a) developing electricity storage and microgrids for critical infrastructure; (b) supporting community solar to provide greater access to renewable energy; (c) reducing carbon emissions from the power sector; and (d) focusing on wetland restoration.

3. The Biden Administration has recently announced a new goal for the United States to achieve a 50% to 52% reduction from 2005 levels in economy-wide net greenhouse gas pollution by 2030. Further, the United States has set a goal to reach 100% carbon pollution-free electricity by 2035, and to achieve net-zero greenhouse gas emissions by no later than 2050. During President Biden's Leaders Summit on Climate, the President set forth several goals to address the climate crisis, including transforming energy systems and implementing nature-based solutions, such as habitat conservation efforts. The sales tax exemptions under AB 68/SB 111 are consistent with these goals.

4. It is generally recommended that states impose a sales and use tax on a broad base at a low rate, with limited exemptions. Exemptions 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 of, and compliance with, the tax. Exemptions can impede economic efficiency by indirectly favoring certain types of distribution channels, methods of business operation, or forms of business organization.

5. On the other hand, sales tax exemptions can be used to encourage purchases of desired goods and services. Therefore, proposed exemptions for energy storage and for landscape planning services for wetland, prairie, and savanna restoration could help encourage consumers to purchase goods and services that promote environmental sustainability.

6. The exemption related to landscaping services would favor landscaping businesses that provide certain restoration planning services over landscaping businesses that provide other types of planning services. However, since the intent of providing this exemption is to address climate change concerns, the Committee could consider whether it wants to favor certain businesses over others in this way.

7. The following sections discuss each proposed exemption in more depth.

Energy Storage

8. DOR interprets the applicability of the current law sales tax exemption for renewable energy systems in its administrative rules, such that the following products qualify for the exemption: (a) wind turbine generators, including blade assembly and tower; (b) gas-powered electric generators; (c) gas-fueled furnaces, space heaters, and water heaters; (d) photovoltaic cells, modules, and arrays, including tracking equipment that maintains optimal orientation to the sun; (e) solar thermal collectors; (f) inverters used to transform direct current produced by an item listed above into alternating current, including property used to convey the direct current from the product to the inverter; and (g) hardware required for installation of the above mentioned items. For the purposes of "b" and "c", "gas" means a fuel that is comprised primarily of methane and exists in a gaseous state at normal room temperature and pressure.

9. The following products enumerated by rule do not qualify for an exemption under current law: (1) tangible personal property that consumes electricity or heat produced by qualified products (i.e. a refrigerator); (2) a foundation for an item that produces electricity or heat energy from certain renewable energy sources; (3) property necessary to convey, transfer, or alter electricity or heat generated from qualified products that produce electricity or heat energy, except as provided in "f" above; and (4) tangible personal property used to store electricity or heat produced by qualified energy-producing products. For example, batteries used to store electricity produced by a wind turbine generator, or a tank that stores hot water heated by a solar collector, are not exempt from the sales tax because they are not products that have a power source that is wind energy or direct radiant energy received from the sun.

10. The administration indicates that DOR has received requests to interpret existing language pertaining to the current sales tax exemption to include items "3" and "4" in point 10. In response, the Governor recommends expanding the current law exemption from the state sales and use tax to include tangible personal property used to store, or facilitate the storage of, electrical or heat energy produced by a solar, wind, or biogas renewable energy system, beginning on the first day of the third month beginning after publication of the bill. The administration indicates that the intent of this exemption is to encourage greater use of renewable energy, and estimates that the proposed exemption would decrease state tax revenues by \$3,800,000 in 2021-22 and \$4,400,000 in 2022-23 and annually thereafter.

11. AB 68/SB 111 would modify current law so that the exemption would apply to solar, wind, and waste energy systems that produce usable electrical or heat energy, rather than solely to products whose power source is solar, wind, or waste energy. Tax exempt sales of solar power systems, wind energy systems, and waste energy systems would include tangible personal property sold with the systems that is used primarily to store, or facilitate the storage of, electrical or heat energy produced by the systems.

12. The current law exemption, as amended by this proposal, would apply to products producing power from renewable energy sources, as well as products used to store that energy, such as batteries, and products used to facilitate the storage of that energy, such as electrical wire necessary to transfer electricity to a battery storage system. However, it should be noted that such products would only be exempt if sold with a qualified energy-producing product. Batteries or electrical wire sold individually at a retail store would still be subject to the state's sales and use tax.

13. Providing sales tax incentives for purchases related to renewable energy production and use is common across states. These incentives can include sales tax exemptions, credits, abatements, holidays, and reimbursements. According to the Solar Energy Industries Association, an advocacy group for renewable solar energy, 25 states provide some sort of sales tax exemption for solar energy, and several states also provide certain wind and biogas exemptions. Another common tax exemption for solar energy, a property tax exemption, is provided by 36 states.

14. One rationale for providing tax benefits for renewable energy sources is to alleviate the challenges associated with a switch from traditional (fossil fuel) to renewable energy sources. Some examples of these challenges include: (a) higher upfront costs; (b) intermittency of renewable energy resource availability; (c) storage capabilities; and (d) geographic limitations. Technology required to

produce renewable energy is often expensive compared to traditional energy generators. As mentioned, a sales tax exemption exists under current law for products used to produce solar, wind, or biogas renewable energy. This exemption likely exists, in part, to help reduce the overall cost of these products, and therefore increase consumer demand. However, due to intermittency, energy storage is needed to ensure uninterrupted power for the user. Therefore, it could be argued that, without an incentive to purchase both energy producing products and energy storage, individuals may not be willing to shift away from traditional energy sources. On the other hand, some may argue that a state sales tax exemption of 5% does not reduce the cost of these products enough to encourage individuals to shift to renewable energy.

15. Wisconsin already provides several sales tax exemptions for fuel and electricity from a number of energy sources. These include, but are not limited to: (a) electricity and natural gas sold for residential purposes from November through April; (b) coal, fuel oil, propane, steam, biomass, peat fuel cubes produced from solid waste, and wood sold for residential fuel for use in a person's permanent, principal residence; (c) electricity and fuel sold for farm use; (d) electricity and fuel consumed in manufacturing; and (e) wood residue used as fuel in a business activity. Given this range of exemptions for various types and uses of energy, it could be argued that providing a sales tax exemption for renewable energy storage to enable reliable renewable energy use would generally allow for consistent sales tax treatment among other exempt types of energy.

16. In addition, AB 68/SB 111 would make the following modifications to clarify the existing sales tax exemption under current law: (a) specify that, to qualify for the exemption, energy systems must continuously, rather than per day, produce at least 200 watts of alternating current or 600 British thermal units; (b) clarify that tax exempt energy produced by the systems includes electrical and heat energy; and (c) specify that the production of electrical or heat energy must come directly from sun, wind, or gas generated from anaerobic digestion of animal manure or other agricultural waste. These modifications would codify DOR's current administration of the exemption and are not expected to have a measurable impact on state revenues.

17. If the Committee would like to provide an incentive for individuals to produce and utilize renewable energy, and it believes that a sales tax exemption on energy storage would accomplish this goal, it could expand the current law exemption for renewable energy systems to include products used to store, or facilitate the storage of, that energy. Additionally, the Committee could make the modifications to clarify the existing sales tax exemption (Alternative A1).

18. However, if the Committee decides not to expand this exemption to include items used to store renewable energy, it may wish to still make the modifications to the language of the current law exemption for energy systems (Alternative A2). Finally, if the Committee decides not to provide an additional incentive for the use of renewable energy systems, or wishes to address this issue in a different way, it could take no action on the proposed sales tax exemption (Alternative A3).

Planning Services

19. According to the Wisconsin Department of Natural Resources (DNR), wetlands provide numerous benefits to the environment and the surrounding community, including: (a) providing fish and wildlife habitats; (b) aiding in flood prevention by storing floodwaters; (c) maintaining surface

water flow during dry periods; (d) providing shoreline erosion control; (e) protecting and improving water quality; and (f) providing opportunities for recreation and aesthetic appreciation.

20. Like wetlands, prairies and savannas also provide habitats for many animals, including birds, butterflies, insects, reptiles, and other wildlife. Many species depend on these ecosystems for their survival. Additionally, the roots found in prairie plants serve multiple purposes, such as: (a) providing rich, fertile soil as a result of natural decay; (b) creating a pathway for water to enter the soil to recharge ground water tables; (c) acting as a water filtration system, which improves water quality; and (d) storing carbon. Prairies can also store rain to reduce erosion and runoff.

21. According to DNR, much of Wisconsin's historical wetland, prairie, and savanna acreage has been lost over time. Today, only 53% (5.3 million) of the state's original 10 million acres of wetlands remain. Of the 2.1 million acres of prairie land that existed 150 years ago, less than 10,000 acres (less than 0.5%) remain today. Finally, less than 0.01% (less than 500 acres) of the estimated 5.5 million acres of oak savanna historically found in Wisconsin remain. DNR notes that oak savanna and tallgrass prairie are the most threatened plant communities in the Midwest, and among the most threatened in the world.

22. The Governor recommends providing a sales and use tax exemption for landscape planning and counseling services that pertain to the restoration, reclamation, or revitalization of prairie, savanna, or wetlands, if such services are provided under a separate and optional fee distinct and identifiable from other taxable services, beginning on the first day of the third month beginning after publication of the bill. Tangible personal property transferred to the customer in conjunction with qualified planning and counseling services would also be exempt from the sales tax. However, the purchase price of such tangible personal property purchased by the seller of qualified landscape planning and counseling services would be subject to tax. The administration estimates that this exemption would reduce state tax revenues by \$200,000 in 2021-22 and \$300,000 in 2022-23 and annually thereafter.

AB 68/SB 111 specifies that taxable landscaping and lawn maintenance services would not include planning and counseling services if the planning and counseling services were provided for a separate and optional fee from any other services and the services were for the restoration, reclamation, or revitalization of prairie, savanna, or wetlands to improve: (a) biodiversity; (b) the quality of land, soils, or water; or (c) other ecosystem functions. The bill would specify that the sale of landscaping and lawn maintenance services, including lawn and garden services such as planting, mowing, spraying, and fertilizing, shrub and tree services, and other planning and counseling services, would remain taxable.

The proposal recommends defining a "separate and optional fee" as a fee charged to receive a distinct and identifiable product if either of the following would apply; (a) the fee is in addition to fees that the seller charges for other distinct and identifiable products sold to the same buyer, the fee is separately set forth on the invoice given by the seller to the buyer, and the seller does not require the buyer to pay the fee if the buyer chooses not to receive the additional distinct and identifiable product for which the fee applies; or (b) the seller charges a single amount for multiple distinct and identifiable products and offers the buyer the option of paying a lower amount if the buyer chooses not to receive one or more of the distinct and identifiable products. The separate and optional fee

would have to be a single amount the seller charges for the multiple distinct and identifiable products, less the reduced amount the seller charges to the buyer because the buyer chooses not to receive one or more of the products.

23. The administration indicates that the intent of this proposal is to encourage private landowners and businesses to engage in the restoration of prairies, savannas, and wetlands. However, the Committee could consider whether a sales tax exemption for these services is enough to alter consumer behavior. Since planning and counseling services for certain restoration efforts would be an added expense for the purchasers of landscaping services, an argument could be made that anyone who desires to utilize these services would do so regardless of whether a sales tax is imposed or not. On the other hand, for individuals who have considered such services but are concerned about the price, a sales tax exemption could be enough to encourage these individuals to utilize planning services for restoration efforts.

24. Additionally, while the proposal would provide a sales tax exemption for the sale of landscape planning and counseling services related to wetland, prairie, and savanna restoration, some services providing for the work to restore these ecosystems would still be subject to the sales tax, provided that the work falls under landscape and lawn maintenance services. These services include planting, mowing, spraying, and fertilizing, as well as shrub and tree services. Therefore, it could be argued that the proposed exemption does not do enough to encourage restoration of these lands, as purchasers would still have to pay sales tax on some of the services related to actual restoration.

25. It is possible that the specification that qualified planning and counseling services must be stated on the bill as a separate and optional fee to qualify for the exemption may place some administrative burden on landscaping companies. Businesses that already provide these services, but include them as one price with all other services provided, would have to alter their billing systems to ensure they qualify for the exemption.

26. The Committee could chose to provide an exemption for qualified planning and counseling services (Alternative B1). On the other hand, the Committee might decide that current state programs related to land restoration and conservation, described below, are sufficient to address climate concerns, and therefore take no action on this proposal (Alternative B3).

27. A number of state incentives already exist in Wisconsin related to the conservation of land and natural resources. Most notably, DNR provides grants through both the land acquisition and the property development and local assistance subprograms of the Warren Knowles-Gaylord Nelson Stewardship program to nonprofit conservation organizations (NCOs). Funds received as grants under the land acquisition subprogram are used to acquire land for a variety of purposes, such as habitat areas, natural areas, streambank protection, trails, and wild lakes. Additionally, under the property development and local assistance subprogram, grants may be given to NCOs for property development and wetland and habitat restoration on land owned by DNR, acquisition of urban green space, acquisition of local parks and urban rivers areas, and for the purchase of development rights (easements) for conservation purposes. NCO grants are allocated \$7 million each year under the stewardship program, although lesser amounts are usually committed to grants. Local assistance grants are allocated \$6 million, and grants for property development on DNR owned land are allocated \$250,000 each year.

28. Likewise, property held by NCOs is exempt from property taxation under the following conditions: (a) the property is used for conservation of natural resources or indigenous heritage; (b) the property is open to public access; and (c) neither the property owner nor any member of an organization that owns the property receives any profit from the property. Because NCOs are nonprofit organizations, their purchases are generally exempt from sales tax.

29. Additionally, state law generally requires a person to obtain a wetland permit from DNR before conducting any activity that results in a discharge of dredged material or fill material into nonfederal wetlands (non-navigable, isolated, intrastate waters). Certain exceptions apply to permitting requirements for small parcels related to agricultural use or found in urban areas. Wetland permitting requirements generally require applicants to demonstrate that there are no feasible alternative development options that would otherwise produce a lesser impact on wetlands. As a condition of permit approval by DNR, a permittee is typically required to conduct wetland mitigation that offsets any unavoidable negative impact on wetlands by creating, conserving, or restoring wetlands nearby the project site, usually within the same watershed. In Wisconsin, wetland mitigation may be undertaken through: (a) a permittee-led project to create, conserve, or restore a wetland; (b) purchasing credits from a wetland mitigation bank, which is a local organization within the same watershed area that conducts mitigation projects to generate mitigation credits; or (c) participating in the Wisconsin Wetland Conservation Trust (WWCT) in-lieu fee program. The WWCT has had average annual revenues of about \$3.5 million since 2014-15, although revenues have been significantly lower in the 2019-21 biennium.

30. The Committee could consider whether these existing programs are enough to address concerns related to the loss of prairie, savanna, and wetland acreage in Wisconsin. Some could argue that these programs (and similar programs) are better suited to address these concerns than a sales tax exemption, as programs do more to address the financial cost of engaging in conservation activities. On the other hand, the stewardship grant programs and property tax exemptions for NCOs are more broadly defined than the proposed sales tax exemption, which focuses specifically on wetland, prairie, and savanna restoration. If the Committee believes that it is important to provide additional incentives for restoring these types of ecosystems, the proposed sales tax exemption could provide an avenue to do so.

31. In place of a sales tax exemption, the Committee could decide to create a GPR appropriation under DNR to support conservation grants. Given the available funding for wetlands restoration and relatively fewer options existing for prairie and oak savanna restoration, the Committee could establish a program for DNR to award grants to NCOs or local governments for restoration activities for prairies and savannas (Alternative B2).

ALTERNATIVES

A. Energy Storage

1. Expand the current law exemption from the state sales and use tax to include tangible personal property used to store, or facilitate the storage of, electrical or heat energy produced by a solar, wind, or biogas renewable energy system (described in greater detail in discussion points #11

and #12). Estimate a reduction in state sales tax revenues of \$3,800,000 in 2021-22 and \$4,400,000 in 2022-23 and annually thereafter. Additionally, make the following modifications to the exemption for energy systems under current law: (a) specify that, to qualify for the exemption, energy systems must continuously, rather than per day, produce at least 200 watts of alternating current or 600 British thermal units; (b) clarify that tax exempt energy produced by the systems includes electrical and heat energy; and (c) specify that the production of electrical or heat energy must come directly from sun, wind, or gas generated from anaerobic digestion of animal manure or other agricultural waste. Specify that these provisions take effect on the first day of the third month beginning after publication of the bill.

ALT A1	Change to Base
GPR-Tax	- \$8,200,000

2. Make the following modifications to the exemption for energy systems under current law: (a) specify that, to qualify for the exemption, energy systems must continuously, rather than per day, produce at least 200 watts of alternating current or 600 British thermal units; (b) clarify that tax exempt energy produced by the systems includes electrical and heat energy; and (c) specify that the production of electrical or heat energy must come directly from sun, wind, or gas generated from anaerobic digestion of animal manure or other agricultural waste. Specify that this provision takes effect on the first day of the third month beginning after publication of the bill.

3. Take no action.

B. Planning Services

1. Provide a sales and use tax exemption for landscape planning and counseling services that pertain to the restoration, reclamation, or revitalization of prairie, savanna, or wetlands, if such services are provided under a separate and optional fee distinct and identifiable from other taxable services (described in greater detail in discussion point #22). Specify that the seller, not the purchaser, of qualified planning and counseling services is required to pay sales tax on the purchase price of tangible personal property transferred to the customer in conjunction with qualified planning and counseling services. Specify that this provision takes effect on the first day of the third month beginning after publication of the bill. Estimate a reduction in state sales tax revenues of \$200,000 in 2021-22 and \$300,000 in 2022-23 and annually thereafter.

ALT B1	Change to Base
GPR-Tax	- \$500,000

2. Provide \$200,000 GPR in 2021-22 and \$300,000 GPR in 2022-23 to DNR in an annual appropriation to support existing conservation of prairies and savannas.

ALT B2	Change to Base
GPR	\$500,000

3. Take no action.

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