



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #111

Sales Tax Treatment of Services to Tangible Personal Property (General Fund Taxes -- General Sales and Use Tax)

[LFB 2001-03 Budget Summary: Page 40, #2]

CURRENT LAW

Additions or Capital Improvements to Real Property. Currently, the sales tax is generally imposed on the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection and maintenance of all items of tangible personal property. However, the tax is not imposed on the original installation or complete replacement of tangible personal property if the installation or replacement would result in an addition or capital improvement to real property. These provisions appear in s. 77.52(2)(a)10.

A separate section of the statutes [s. 77.51(15)(c)(2)] provides that the amount received for labor or services for installing or applying property which, when installed or applied, will constitute an addition or capital improvement of real property is excluded from the definition of sales price so long as the amount is separately stated from the amount charged for the property. Therefore, services that meet these criteria are not subject to the sales tax.

Business Equipment. The current statutes regarding the taxation of services to tangible personal property also specify a number of types of property that are deemed to have retained their character as tangible personal property, regardless of the extent to which any such item is fastened to or built into real property. Among these are "office, restaurant and tavern type equipment."

GOVERNOR

Modify s. 77.52(2)(a)10 by eliminating the exception for installing or applying tangible personal property which, when installed or applied, will constitute an addition or capital

improvement of real property. The provision excluding amounts paid for such services from the definition of taxable sales price under in s. 77.51(15)(c)(2) would be retained.

Specify that items that remain tangible personal property, regardless of the extent to which those items are attached to real property, include "equipment in offices, business facilities, schools and hospitals," rather than "office, restaurant and tavern type equipment" to clarify that any equipment used in these nonresidential settings would retain its character as tangible personal property, regardless of the type of equipment.

DISCUSSION POINTS

1. The Department of Revenue (DOR) indicates that its long-standing position has been that the repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection, and maintenance of tangible personal property are subject to the sales tax, even though performing these services arguably could result in an addition to or capital improvement of real property. In contrast, the original installation or complete replacement of an item which results in an addition to or capital improvement of real property is not subject to the state's sales tax. The Governor's provisions are intended to clarify the statutes to reflect DOR's current treatment of such transactions. Therefore, no fiscal effect is estimated.

2. However, DOR indicates that, as drafted, the bill could have the unintended effect of imposing the sales tax on all installations of tangible personal property, including installations that become a part of real property when installed. Therefore, DOR recommends that the Committee adopt a technical modification specifying that the sales tax would apply to the service of installing or applying tangible personal property to the items deemed to retain their character as tangible personal property, regardless of whether the installation or application constitutes an addition or capital improvement of real property; but not to the original installation or complete replacement of an item listed if the installation or replacement constitutes a real property construction activity as defined in s. 77.51 (2). In recommending these changes, DOR hopes to clarify existing policy.

3. As evidence of the need to clarify current policy by adopting the bill's provisions, in combination with the suggested modification, DOR cites a 1996 case decided by the Wisconsin Tax Appeals Commission in which a taxpayer argued that the application of a resin surface to a worn, discolored bathtub constituted the application of tangible personal property which in turn brought about a capital improvement to real property. As a result, the taxpayer argued, the application services should not have been subject to the sales tax. In response, DOR argued that the taxpayer merely was repairing the worn bathtub. DOR presented expert testimony that the refinishing did not increase the value of the property and eventually prevailed in the case. Nonetheless, the Department remains concerned that, under current law, its long-standing position is in question and, as a result, it could face a similar case in the future with a possibly adverse outcome. DOR indicates that reversal of its policy could cost the state substantial revenue.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation with the technical modifications recommended by DOR.
2. Maintain current law.

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