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Sales and Use Tax on Electronic Versions of Certain Personal Property (General Fund Taxes -- General Sales and Use Tax)

[LFB 2005-07 Budget Summary: Page 196, #2]

CURRENT LAW

Under current law, the 5% state sales and use tax is generally imposed on gross receipts from the sale and rental of tangible personal property. In addition, the sales and use tax is specifically imposed on the sale and use of selected services. There is no imposition of tax on sales of real property or intangible property, unless the item would fall within one of the services that are subject to Wisconsin sales tax.

With some exceptions, items transferred in electronic form through the internet are not currently taxable, even if the item would be taxable if transferred in tangible form (for example, a novel purchased via the internet in digital format and then printed would not be subject to the tax, whereas the same novel purchased as a paperback book would be subject to the tax). However, current law makes the following exceptions to this general approach:

a. Computer software, excluding custom software, is defined by state law to be tangible personal property for purposes of the sales and use tax, without regard to the form in which it is transferred.

b. Taking photographs, reproducing them in a digital format and delivering them electronically is a taxable service.

c. Pay-per-view movies, movie channels, and similar means of viewing motion pictures are cable television services that are specifically subject to tax. However, movies downloaded via the internet may not meet Wisconsin's current definition of cable television service, which requires amplification of the program.

GOVERNOR

Impose the state sales and use tax on selected products furnished to customers electronically that would be subject to the tax if furnished in tangible form, effective on the first day of the second month beginning after publication of the bill. Estimate increased sales tax revenues under this provision of $1,300,000 in 2005-06 and $1,900,000 in 2006-07. The first-year estimate reflects an effective date of September 1, 2005.

As described above, current law generally imposes the sales and use tax on tangible personal property, and specifically imposes the tax on selected services. The bill would create new provisions specifically imposing the sales and use tax on four types of electronic products, including audio works, audiovisual works, finished artwork, and literary works. The bill would define these electronic products as follows:

a. "Audio works" would mean works that result from the fixation of a series of musical, spoken, or other sounds, including prerecorded or live music, prerecorded or live readings of books or other written materials, prerecorded or live speeches, and digitized sound files that are downloaded to a telephone handset. "Audio works" would not include broadcast radio services or sounds accompanying an audiovisual work.

b. "Audiovisual works" would mean a series of related images that, when shown in succession, impart an impression of motion, together with sound, including motion pictures, musical videos, and live events. "Audiovisual works" would not include broadcast television services or cable television system services.

c. "Finished artwork" would mean the final art used for actual reproduction by photomechanical or other processes or for display purposes. "Finished artwork" would also include all of the following items, regardless of whether the items are reproduced: drawings; paintings; designs; photographs; lettering; paste-ups; mechanicals; assemblies; charts; graphs; and illustrative materials.

d. "Literary works" would mean works, not including audiovisual works, audio works, and computer software, that are expressed in words, numbers, or other verbal or numerical symbols or indicia, including books and periodicals.

The bill would impose the sales and use tax on the electronic products described above through provisions that would be consistent with the general treatment of taxable items under current law. In addition, the bill would provide an exemption from the sales and use tax for any of such electronic products that would be exempt from tax if transferred in a tangible form.

DISCUSSION POINTS

1. In recent years, the United States Census Bureau has issued quarterly and annual reports providing estimates of e-commerce and total retail sales in the U.S. In the most recent

reports available, national e-commerce sales for 2004 were estimated at $69.2 billion, which represents an increase of 23.5% over 2003. Total retail sales were estimated to have increased 7.8% for the same period.

2. A Census Bureau report comparing estimates of quarterly U.S. retail e-commerce sales as a percent of total quarterly retail sales from the 4^{th} quarter of 1999 through the 4^{th} quarter of 2004 attributes a steadily increasing proportion of all retail sales to e-commerce; whereas an estimated 0.6% of all U.S. retail sales in the 4^{th} quarter of 1999 were from e-commerce, that percentage had risen to 2.0% in the 4^{th} quarter of 2004. These estimates represent seasonally adjusted data.

3. A portion of e-commerce retail sales consists of electronic products that have previously been sold primarily as tangible personal products. These products include, for example, music, movies, on-line video and other games, books, periodicals, finished artwork, and television and radio commercials. Such products are subject to the state's sales and use tax when sold in tangible form. However, with the exceptions described above under "Current Law," the state does not currently impose sales and use taxes on intangible products. As technology continues to evolve, it is expected that the sales volume of electronic versions of such items will increase, leading to erosion of the sales tax base and disadvantaging Wisconsin brick and mortar retailers (whose sales of the tangible versions of such products are subject to the sales tax).

4. Under the proposal, a vendor of the electronic products that would become subject to the state sales and use tax would have to collect the tax at the time of the sale if the vendor had sufficient nexus (physical presence) with the state or had voluntarily agreed to collect the tax. If a seller does not have nexus and has not voluntarily agreed to collect the tax, the state imposes a use tax on taxable purchases from the seller by state residents. However, collecting the use tax from individual purchasers presents a difficult enforcement issue.

5. Digital music is one of the intangible products that would become taxable under the proposal. A primary vendor of music in digital form is the iTunes Music Store. According to the Music Store's website, invoices for downloads of music currently include local taxes on music downloads by residents of the following states: Alabama, Arizona, Colorado, Connecticut, Washington D.C., Hawaii, Idaho, Indiana, Louisiana, Maine, New Mexico, North Dakota, South Dakota, Tennessee, Texas, Utah, and Washington.

6. According to a survey of other states by the Department of Revenue (DOR), Iowa, Kentucky, and New Jersey also currently impose the sales tax on digital versions of music. Based on information from the DOR survey and the iTunes Music Store website, it appears that approximately one-third of the 45 states plus the District of Columbia that impose a state sales tax currently impose the tax on digital versions of music. In a recent digital goods survey by the Streamlined Sales and Use Tax Project, 12 of 27 responding states reported that the state's sales and use tax is generally levied on products delivered electronically (the question excluded pre-written computer software, which is treated as a separate item by many states).

7. The administration has estimated that the proposed sales tax on electronic versions of audio works, audiovisual works, finished artwork, and literary works would result in increased state sales and use tax collections of $1.3 million in 2005-06 and $1.9 million in 2006-07. In addition, it is estimated that approximately $100,000 would be collected in each year through the county and stadium district taxes. The estimates are based on various industry and media reports, and assume annual growth in sales of goods that would become taxable under the proposal of 20%. The administration's estimates are consistent with general growth in e-commerce in recent years as reported by the U.S. Census Bureau.

8. The estimated fiscal effect included in the bill assumes a 90% compliance rate, which is within the range of compliance rates that DOR typically uses in estimating the effect of sales tax proposals. However, unlike most sales tax proposals, this proposal is specific to sales of products that are likely to be sold by remote sellers, rather than in brick and mortar stores within the state. As described above, sellers of electronic products that would become taxable under the proposal would not be required to collect the tax if they do not have nexus with Wisconsin.

9. Other than the iTunes Music Store, no data has been found suggesting that sellers of the electronic products described above would be likely to collect Wisconsin sales and use taxes based on having nexus with the state or voluntarily agreeing to collect the tax for the state. Given the expectation that an unusually high proportion of such sales would be made from remote vendors, it seems unlikely that the compliance rate would be the same as that generally observed with respect to tangible products.

10. It is not possible to predict with precision the actual compliance rates that would occur if the proposal were enacted into law. However, it seems reasonable to reduce the projected compliance rates to reflect the difference between the manner in which electronic products and tangible personal property are typically sold. Assuming a 100% compliance rate for sales and use tax collections from sales of audio works under the proposal and a 20% compliance rate for the remaining electronic products described above, it is estimated that the proposal would increase state sales and use tax collections by $520,000 in 2005-06 and $760,000 in 2006-07, for a biennial total of $1,280,000. These estimates are $780,000 lower in 2005-06 and $1,140,000 lower in 2006-07 than the estimates under the bill. The first-year figures assume an effective date of September 1, 2005. Based on the revised estimates, it is projected that county and stadium district sales tax collections would be approximately $50,000 per year.

11. It should be noted, however, that if the state sales and use tax laws were modified to conform to the provisions of the Streamlined Sales and Use Tax Agreement, as would be provided under the bill, and if, as a result of the multi-state Agreement taking effect, more remote sellers would voluntarily agree to collect state use taxes, the rate of compliance could increase to the 90% rate assumed by DOR in future years.

ALTERNATIVES

1. Approve the Governor's proposal. However, reduce the estimated sales and use tax revenues under these provisions to $520,000 in 205-06 and $760,000 in 2006-07. Compared to the bill, reduce the estimated fiscal effect of the proposal by $780,000 in 2005-06 and by $1,140,000 in 2006-07.

Alternative 1	GPR-REV
2005-07 REVENUE (Change to Bill)	**-** $1,9200,000

2. Maintain current law.

Alternative 2	GPR-REV
2005-07 REVENUE (Change to Bill)	**-** $3,200,000

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