



## Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #333

### **Sales Tax Exemption for Catalogs (General Fund Taxes -- General Sales and Use Tax)**

#### *Bill Agency*

[LFB 2007-09 Budget Summary: Page 188, #4]

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#### **CURRENT LAW**

Current law imposes the state's 5.0% general sales tax on the gross receipts from the sale and rental of tangible personal property, unless specifically exempted. In addition, the tax is imposed on services specifically listed in the statutes, including the service of producing, fabricating, processing, printing, or imprinting of tangible personal property for consumers who furnish the materials. An exception to the general imposition of tax on such services is provided if the property will subsequently be transported and used solely outside this state by the purchaser for advertising purposes.

Current law also provides a sales tax exemption for the gross receipts from the storage of printed material designed to advertise and promote the sale of merchandise or to advertise the services of individual business firms, if such printed material is purchased and stored for the purpose of subsequently transporting the material outside the state by the purchaser for use solely outside the state. In addition, current law exempts the following materials and services: (a) raw materials used for the processing, fabrication, or manufacturing of, or the attaching to or incorporating into, printed materials that are transported and used solely outside Wisconsin, even if the printed materials are not sold; and (b) charges for services rendered in preparing material for mailing, including addressing, enclosing, sealing, metering, affixing stamps, sorting, tying, and sacking in compliance with postal rules and regulations, if the charges are stated separately on invoices and in accounting records.

Under current law, in addition to the sales tax, a use tax is imposed on the use or consumption in this state of taxable property or services purchased from an out-of-state retailer. A credit is provided for the amount of any sales tax paid in the state where the good or service was purchased. "Use" includes, in part, the exercise of any right or power over tangible personal property or taxable services incident to the ownership, possession, or enjoyment of the property or services. "Enjoyment" includes a purchaser's right to direct the disposition of property, whether or not the purchaser has possession of the property. "Enjoyment" also includes, but is not limited to, having shipped into this state by an out-of-state supplier printed material that is designed to promote the sale of property or services, or that is otherwise related to the business activities, of the purchaser of the printed material or printing service.

## **GOVERNOR**

Create a new sales tax exemption for the sale of and the storage, use, or other consumption of catalogs, and the envelopes in which the catalogs are mailed, that are designed to advertise and promote the sale of merchandise or to advertise the services of individual business firms. A "catalog" would mean a printed and bound, stitched, sewed, or stapled book containing a list and description of property or services for sale, regardless of whether a price is specified.

In addition, the bill would modify the current exception to the general imposition of sales tax on the service of fabricating, printing, and imprinting certain tangible personal property. Currently, the exception applies to printed advertising materials which are to be transported out of the state by the purchaser and used solely outside of Wisconsin. The bill would also provide an exception for exempt catalogs and envelopes.

The proposed exemption for catalogs and their mailing envelopes would take effect on April 1, 2009. The administration estimates that the proposal would reduce sales and use tax collections by \$600,000 in 2008-09, and by \$2,400,000 per year in subsequent years (in 2008-09 dollars).

## **DISCUSSION POINTS**

1. According to staff of the State Budget Office, the proposed exemption for catalogs, and the envelopes in which the catalogs are mailed, that are designed to advertise and promote the sale of merchandise or to advertise the services of individual business firms (referred to in the rest of this paper as "catalogs"), is intended to address a concern of Wisconsin printers that Wisconsin's sales and use tax puts such printers at a competitive disadvantage compared to certain out-of-state printers.

2. Currently, Wisconsin printers must always charge sales tax on printed advertising material delivered in Wisconsin (unless a specific exemption applies). Out-of-state printers that have nexus with Wisconsin (sufficient physical presence in the state) must also charge tax on printed advertising material delivered in Wisconsin. Out-of-state printers without nexus are not

required to collect the tax on printed advertising materials delivered in Wisconsin. However, a Wisconsin purchaser is required to pay use tax on printed advertising materials purchased from an out-of-state printer in the following situations: (a) the printed advertising materials are delivered to the purchaser (or purchaser's place of business) for use in the state; or (b) the printed advertising materials are delivered to a third party [such as a mailing company or a newspaper (for insertion of such materials in a Wisconsin newspaper)] for use in the state. Under these two circumstances, a Wisconsin purchaser pays either sales or use tax on its purchases of catalogs for in-state delivery, and there is no advantage to the purchaser (in terms of tax avoidance) of doing business with an out-of-state printer vs. an in-state printer.

3. There is one situation, however, in which an in-state purchaser from an out-of-state, non-nexus printer is not responsible for either sales or use tax on deliveries of catalogs for use in Wisconsin. In 1982, the Wisconsin Court of Appeals, District IV, held (in the case of *Wisconsin Department of Revenue vs. J.C. Penney, Inc.*) that a purchaser's catalogs published by an out-of-state, non-nexus printer and shipped directly to the purchaser's customers in Wisconsin by mail or common carrier do not meet the state's definition of "use" for purposes of the use tax, and are not subject to Wisconsin use tax. As a result, a Wisconsin purchaser can avoid paying sales and use tax on printed advertising materials by purchasing such materials from an out-of-state, non-nexus printer and having the materials delivered directly to the purchaser's Wisconsin customers by mail or common carrier. It is this situation (sometimes referred to as the *J.C. Penny* effect) that currently may serve as an incentive for an in-state purchaser to purchase catalogs from an out-of-state, non-nexus printer and arrange for the printer to deliver the catalogs directly to the final Wisconsin destination, thereby avoiding the state's 5% sales or use tax.

4. The competitive disadvantage created by the *J.C. Penny* effect could be eliminated in one of two ways. First, the sales and use tax on catalogs could be eliminated, which the bill would provide for, effective April 1, 2009.

5. A second approach, which would also eliminate the incentive for an in-state purchaser to purchase catalogs from an out-of-state, non-nexus printer, would be to modify the current definition of "use" to include the activities currently considered exempt from use tax as a result of the *J.C. Penny* decision. It should be noted that the bill already includes such a modification to current law under other provisions pertaining to a proposal to conform to the provisions of the Streamlined Sales and Use Tax Agreement (SSUTA). The modification under the SSUTA proposal would specify that, for purposes of the sales and use tax statutes, "exercise of any right or power over tangible personal property or taxable services" (as used in the definition of "use") includes distributing, selecting recipients, determining mailing schedules, or otherwise directing the distribution, dissemination, or disposal of tangible personal property or taxable services, regardless of whether the purchaser owns or physically possesses, in this state, the property or services. This provision, which would eliminate the *J.C. Penny* effect, could be adopted regardless of whether or not the rest of the SSUTA proposal was approved. The result of this approach would be that Wisconsin purchasers currently avoiding the use tax by purchasing catalogs (and other forms of direct mail advertising) from out-of-state, non-nexus printers would become subject to tax at the same levels as in-state purchasers purchasing catalogs from in-state printers.

The administration has estimated that, as a result of the proposed elimination of the *J.C. Penney* effect, state sales and use tax revenues would increase by \$500,000 in 2007-08 and by \$1,100,000 in 2008-09 and annually thereafter (in 2008-09 dollars). (Even if the SSUTA proposal were removed from the bill, the Committee could choose to eliminate the *J.C. Penney* effect).

6. Of the two approaches outlined above to reduce the current competitive disadvantage for Wisconsin printers, the industry would prefer the elimination of the sales tax on catalogs. Under this approach, not only would the competitive disadvantage be eliminated, but the industry would also be able to essentially reduce its charges to catalog customers by 5%.

7. It should be noted that the administration has requested a technical correction in the bill's provision related to the general imposition of the sales tax on the service of fabricating, printing, and imprinting tangible personal property. The intention is to provide exceptions to the general imposition language for services eligible for either the current law exemption for printed materials to be used outside the state (as modified under the bill) or the proposed catalog exemption. As drafted, the bill would provide an exception for services eligible for both exemptions (which would not be possible). The bill should be amended to correct this drafting error.

**ALTERNATIVES TO BILL**

1. Approve the Governor's proposal along with the technical modification requested by the administration. Compared to current law, this alternative would reduce state sales and use tax revenues by an estimated \$600,000 in 2008-09.

ALT 1	Change to Bill Revenue	Change to Base Revenue
GPR	\$0	-\$600,000

2. Delete the Governor's proposal. Instead, modify the definition of "use" to eliminate the *J.C. Penney* effect (as the bill would already do under the SSUTA proposal), which would result in all direct mail advertising delivered for use in the state being subject to either the sales or use tax, regardless of whether the purchaser or the printer made the final deliveries. Specify that the modification to "use" under this alternative would take effect January 1, 2008 (as would be provided under the SSUTA proposal).

Under this alternative, estimated sales and use tax revenues would be increased by \$600,000 in 2008-09 as a result of the deletion of the proposed sales and use tax exemption for catalogs. In addition, compared to current law, sales and use tax revenues would increase by an estimated \$500,000 in 2007-08 and \$1,100,000 in 2008-09 from the elimination of the *J.C. Penney* effect. However, these estimated increases in sales tax revenue are already included in the bill as part of the estimated fiscal effect of the SSUTA provisions. Therefore, if the SSUTA provision remained in the bill, there would be no need to adjust sales and use tax revenues as a result of eliminating the *J.C.*

*Penney* effect under this alternative. However, if the SSUTA provisions were deleted from the bill, estimated sales and use tax revenues under this alternative would have to be increased by \$500,000 in 2007-08 and \$1,100,000 in 2008-09.

<b>ALT 2</b>	<b>Change to Bill Revenue</b>	<b>Change to Base Revenue</b>
GPR	\$600,000	\$0

3. Delete provision.

<b>ALT 3</b>	<b>Change to Bill Revenue</b>	<b>Change to Base Revenue</b>
GPR	\$600,000	\$0

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