THE ONLINE EFFECT

Shift to Internet Retailers Benefits Income Taxpayers Not Budget

Even as sales tax collections overall slipped 10% for May amid the COVID-19 crisis, internet sales have shot upward as consumers flocked online. But instead of being a bright spot for a struggling state budget, this shift toward e-commerce will add to an income tax cut required under state law.

As the coronavirus pandemic has battered Wisconsin's economy, most of the state's main tax collections have declined in recent months from their 2019 totals. Newly released state collections for May 2020 show income, sales, and excise taxes all falling substantially over the same month last year.

Yet the same crisis that has depressed most of the state's economy and taxes has boosted online sales as consumers avoided stores. In many states, the rise in taxes from online sales will serve to offset some of the state revenues lost due to declines at restaurants, bars, hotels, and other affected businesses.

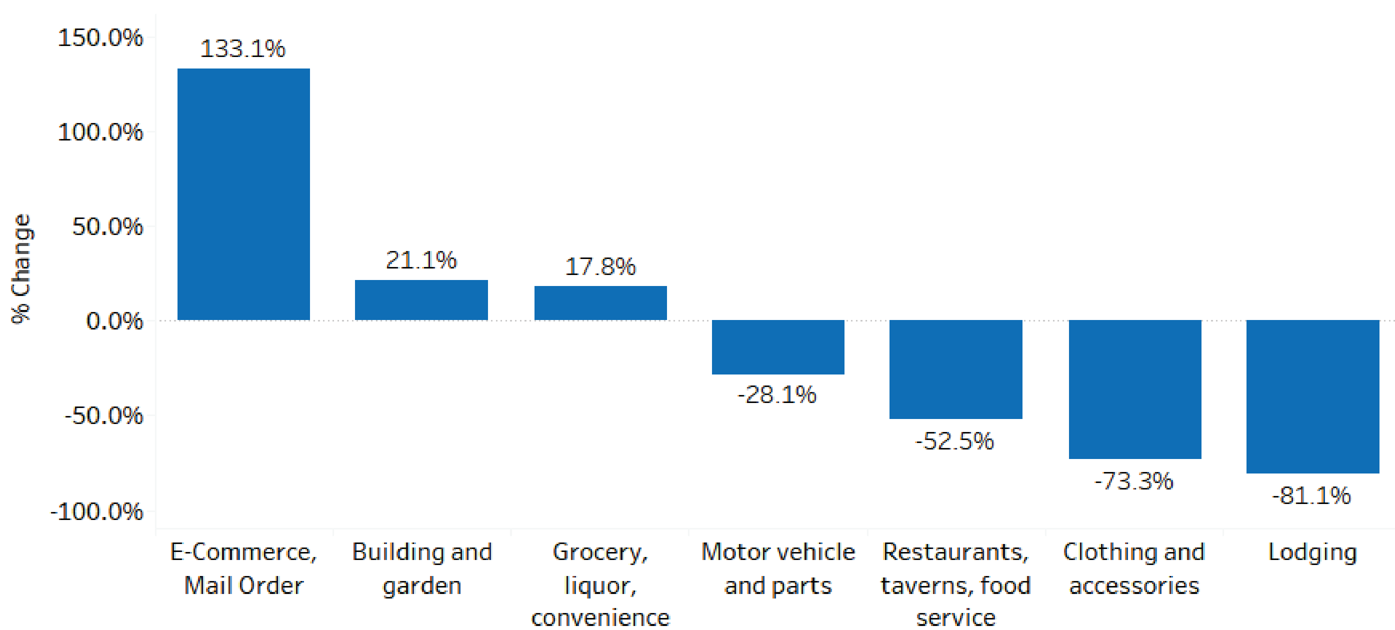
Wisconsin law, however, requires the additional revenue reported by certain online and out-of-state businesses to be used to cut income tax rates. State officials were already projecting a sizable income tax cut of $119 million for 2020, up from $77 million last year. But new data from the state Department of Revenue (DOR) makes clear that the actual tax cut will be much larger and might even come close to doubling the initial projection.

THE BACK STORY

The state imposes a 5% sales and use tax on the purchase of certain goods and services and 68 of the state's 72 counties add a 0.5% county sales tax.

Figure 1: Online Commerce Rises as Most Other Segments Slide

% Change in State Sales and Use Tax Collections, April 2019 Retail Sales to April 2020



Source: Wisconsin Department of Revenue

Previously, no state or county sales and use taxes were collected on online or other sales made to Wisconsin consumers by out-of-state businesses unless the consumers remitted the taxes themselves or those businesses had a nexus with Wisconsin, such as employees in the state or a physical location here such as a store or warehouse.

The 2018 U.S. Supreme Court ruling in *South Dakota v. Wayfair, Inc.* changed that by providing states wider latitude to tax out of state sales. Anticipating a federal change, Wisconsin lawmakers had previously amended state law in 2013 to require that any increase in sales taxes attributable to out of state businesses with no physical presence in Wisconsin must be used to lower state income tax rates by a corresponding amount.

Legislation approved last year (Wisconsin Act 10) also required sales and use tax collections by out of state lodging and other online marketplaces facilitating sales by third parties such as Airbnb (though that particular business had already been collecting sales taxes). The money is used to lower rates in the state's two lowest income tax brackets.

DOR and the Legislative Audit Bureau reported that Wayfair led to an increase in sales and use tax collections of $79.2 million for the 12 months running from Oct. 1, 2018 to Sept. 30, 2019. Income tax rates for 2019 were lowered in turn to produce a cut of nearly the same amount.

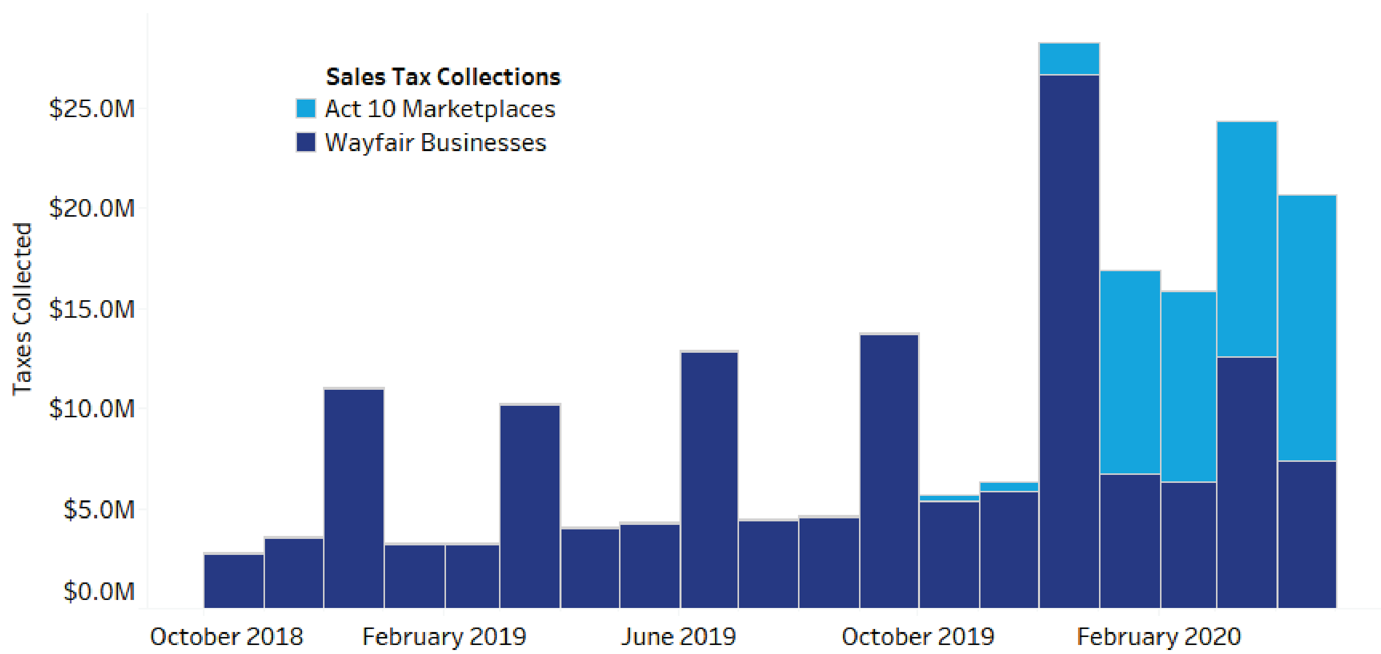
Even pre-COVID-19, sales and use tax collections and the resulting income tax cut for 2020 were expected to rise substantially to $119 million due to Wayfair and the marketplace provisions of Act 10. Yet it's already clear the loss to the state – and savings to taxpayers – will be much greater given the unusual impact of the pandemic on retail sales and taxes (a point made last month by the Legislative Fiscal Bureau). As Figure 1 on page 1 shows, May 2020 collections (on April 2020 sales) by online and catalog retailers more than doubled revenues from April 2019 sales while many other businesses in Wisconsin saw massive declines.

INCOME TAX CUT AHEAD

It is important to note the online and mail order businesses shown in Figure 1 do not exactly match the businesses and sales taxes that trigger lower income taxes under Act 10. DOR has not yet finalized its approach for doing this calculation this year. However, at the Forum's request, DOR provided preliminary October 1 to April 30 data on out of state businesses that began submitting sales taxes after the Wayfair decision as well as online marketplaces covered by Act 10. These figures should provide at least a rough sense of a potential 2020 tax cut.

Figure 2: Rising Online Sales Taxes To Trigger Income Tax Cut

Sales and Use Tax Collections by Internet and Mail Order Merchants Covered by Act 10 in Millions



Source: Wisconsin Department of Revenue

As of April 30 – with five months of collections to go before the Act 10 calculation cutoff of September 30 – sales and use tax revenues from these businesses had already hit $118.1 million. That more than triples the $38 million collected on sales taxes from the same seven-month period a year ago and nearly equals the $119 million projected for this year prior to the coronavirus.

These sales tax collections were already running ahead of projections before the pandemic and that has only intensified since then, with nearly $45 million of the collections coming in March and April alone (see Figure 2). Given the current trend, it is reasonable to think collections could top $200 million for October 2019 through September 2020 and even come close to doubling the initial estimate, automatically triggering a corresponding cut in income taxes.

Wisconsin's approach of tying these increased sales tax revenues to income tax cuts appears to be unusual if not unique. Researchers at the national Tax Foundation say they are not aware of another state that has expressly established this link in statute. The closest example may be Iowa, which accounted for its new online and out of state sales tax revenues in a broader 2018 tax overhaul that also reduced income and corporate tax rates.

CONCLUSION

Some may welcome this unexpectedly large income tax cut. The global economic crisis has left many workers and business owners looking for relief and some also may argue that putting more cash in the hands of consumers will help the economy by generating more spending.

However, the actual income tax cut generally will not benefit the consumers currently paying somewhat more in sales taxes until they file their 2020 income tax returns in early 2021. By then the state is likely to face a budget challenge if not a crisis, given that the Legislative Fiscal Bureau has reported state general fund tax collections so far this fiscal year are running $380 million behind last year.

For that reason, some might argue for limiting the income tax cut under Act 10 to some amount such as $119 million – the sum expected prior to the pandemic. Doing so might avoid some of the need for spending cuts or increases in other taxes to balance the state budget.

WPF takes no position on this or other policies. We highlight this provision, however, so the public and state officials can make an informed choice about whether to amend or retain it.