

# FOCUS

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## In brief

*When a small business owner or firm writes a check to pay taxes, who really pays the bill? The customer? The owner or shareholders? The employees? Other taxpayers? Economists say it is a mix of these. "BJ's Lemonade" offers a fictional case study of how a small business might shift its tax burden to consumers, employees or other taxpayers.*

## Capitol notes

- *The state has denied a merger request from the village and town of Rochester in Racine county. The two will try again under a new state law. The Census Bureau reports that Wisconsin has 3,000 units of government.*
- *State Department of Revenue offices in Kenosha and Racine have been combined in a new Kenosha location.*
- *In the face of falling state financial help, a senior University of Virginia official said in June that UVA is "committed to becoming the first privately funded public university."*
- *Come January 1, builders and homeowners face new requirements under the Home Safety Act of 2003. For information, call the state Department of Commerce at 608-266-3151, or go to [www.commerce.wi.gov](http://www.commerce.wi.gov).*

## Tax lessons from the lemonade business

For three summers during the annual Sunnyvale Music Festival, the village's youngest entrepreneur, Billy Jean "BJ" Gates, had operated the area's only premium lemonade stand. Offering genuine, ice-cold lemonade for only \$2.00, it drew hundreds of vacationers each week.

"BJ's Lemonade" was a profitable business. Employing Billy and two young helpers, it grossed \$1,000 per week, \$5,000 during the five-week festival season. Total net profits of \$1,000 covered BJ's community-college tuition for the school year following.

### Costs rise, consumers pay more

□ *The first week.* The stand opened in mid-July to a profitable and uneventful first week. Total revenues were \$1,000, as expected. After \$800 in expenses, profits for the week were \$200. Billy Jean's costs included: \$600 for employee pay; \$100 for lemons, sugar and other ingredients; and \$100 for operating costs, including utilities, equipment, rentals and ads.

□ *The second week.* The next week presented an unfortunate surprise. A hard freeze that had damaged the lemon crop late last winter finally reached the marketplace. In one week, the cost of lemons rose by two-thirds.

□ *Shifting costs.* If Ms. Gates was to protect her profit margins and clear the \$1,000 needed to pay tuition, changes were necessary. She raised her price from \$2.00 to \$2.10 per glass, passing the increased cost of lemons on to her customers.

With widespread public knowledge of the winter freeze, Billy felt she could introduce a modest price increase without adversely affecting sales. By the close of the week, it was clear that

### Sm. Business Responds to Cost Increases

Wk	Event	Bus. Action	Impact
1	None	None	None
2	Lemon Prices Increase	Price Hike to \$2.10	Consumers Pay More
3	New Village License Fee	Price Hike to \$2.15	Consumers Pay More
4	Co. Min. Wage Law	Wages Up; Staff Hrs. ↓	Employee Earnings ↓
5	Sugar Prices Increase	None Practicable	Owner "Eats"
End	Pay 4% Bus. Profits Tax	Claim Small Bus. Tax Cr.	Gov. Rev's Reduced

Billy's strategy had paid off. Sales held up, and the weekly profit goal of \$200 was reached.

### New tax shifted to customers

As the music festival began its third week in the middle of a heat wave, the village imposed a \$25 per week license fee on all outdoor vendors. A new and unexpected cost of doing business, the fee forced BJ to scramble to maintain her margins. Although there had been some grumbling about last week's price increase, she felt a second, smaller increase to \$2.15 would fly, given the hot temperatures.

Billy lucked out again. Sales volume was maintained, and the nickel price increase generated just enough additional revenue from customers to cover the new \$25 fee.

### Wage law hits employees

The lemonade stand had two employees in addition to Billy Jean. BJ thought she paid them reasonably well. After all, they received \$6.00 per hour, while other vendors at the music fest paid teen help only \$5.50.

□ *County wage mandate.* Some county officials didn't see it that way. Members of the county governing body

enacted an ordinance requiring that festival vendors pay a minimum wage of \$8.00 per hour.

□ *Tough decision.* Billy didn't know what to do. Before, it was her ingredient and operating costs that rose. Now, her payroll costs were about to jump by one-third. This time, however, she couldn't pass on her new costs to consumers through a price increase. Her sales would be adversely affected.

Gates came to a painful conclusion. Although she appreciated the hard work of her longtime employees, the only way she could satisfy the new county ordinance and pay tuition come fall was to reduce by half the hours of one of her employees. "I'll have to put in more hours," Billy thought. In the end, BJ essentially gave herself a pay cut, working more hours for the same income.

### BJ "eats" sugar hike

The fifth and final week of the Sunnyvale Festival brought with it one last challenge for BJ's Lemonade. Unprecedented industry and consumer demand led to a sudden spike in sugar prices and a potential \$25 hole in her anticipated profits for the week.

Given previous actions, neither further price increases nor staff reductions were viable. Rather than alienate satisfied repeat customers or further an-

ger devoted employees going into next season, BJ decided to "eat" the hike in sugar prices. Although she grossed a record \$1,075 in revenue that week, profits dipped from \$200 to \$175. Profits for the season totalled \$975.

### Closing the books

The only work left was to pay the 4% business profits tax. Billy owed \$39 ( $\$975 \times .04$ ). However, a \$50 refundable, small-business tax credit left her with an \$11 tax refund and \$986 in final profits—just \$14 short of the coming year's tuition bill.

By using the income tax credit, Billy shifted \$50 in business costs to the government—and potentially other taxpayers—through reduced tax collections.

### Lemonade lessons

The tale of Billy Jean is fictitious. But it reminds us that, when a tax form is completed and a check written to the appropriate authority, the tax might ultimately be paid by someone else.

Taxes and fees are costs, like salaries, utilities or raw materials. To make money, people or businesses try to shift costs to: consumers through higher prices; employees through reduced pay or staffing; or the government (and other taxpayers) through tax benefits. When that is not possible, the taxpayer/owner will write the check and bear the burden of the tax.



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