Legislative Fiscal Bureau

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TO: Members
Wisconsin Legislature

FROM: Bob Lang, Director

SUBJECT: January 2014 Special Session AB 1 and SB 1 -- Joint Committee on Finance

On January 23, 2014, Governor Walker called the Legislature into special session to address two bills. One of the bills (AB 1 and companion SB 1) relates to general fund taxes and property taxes.

On February 11, AB 1 was taken up by the Assembly and passed, as amended, on a vote of 62-37.

On February 19, the Joint Committee on Finance held an executive session on both AB 1 and SB 1 and recommended the bills for passage, as amended, on a vote of 12-4. The Finance Committee adopted SA 1 to AB 1 and SA 1 to SB 1. With the adoption of those amendments, the bills, as recommended by Joint Finance, are identical.

Attached is a summary of the provisions of AB 1 and SB 1 as passed by the Joint Committee on Finance. Table 1 is a 2013-15 general fund condition statement of AB 1 and SB 1. Table 1 incorporates all legislation enacted to date in the current legislative session (through 2013 Act 134). As shown in Table 1, the projected gross general fund balance at the end of the biennium (June 30, 2015) would be $178.1 million. Under the bills, the structural deficit for the 2015-17 biennium would be -$658 million (-$252 million in 2015-16 and -$406 million in 2016-17).

Table 2 displays the 2013-15 general fund fiscal effects of the provisions of AB 1 and SB 1 and the change in the individual income tax withholding tables. The tables are followed by a description of each of the provisions of the two bills.

BL/sas
Attachment

General Fund Taxes and Property Taxes

(AB 1 and SB 1)

TABLE 1

2013-15 General Fund Condition Statement

AB 1 and SB 1 -- Joint Committee on Finance

	2013-14	2014-15
Revenues		
Opening Balance, July 1	$759,205,000	$725,003,900
Taxes	14,229,890,000	14,731,600,000
Departmental Revenues		
Tribal Gaming	23,703,600	23,533,600
Other	576,818,000	535,113,000
Total Available	$15,589,616,600	$16,015,250,500
Appropriations, Transfers, and Reserves		
Gross Appropriations	$15,026,592,200	$15,916,943,600
Mental Health Bills (Acts 126 to 132)	1,845,000	2,375,000
Sum Sufficient Reestimates	-5,001,900	-16,615,800
Transfers to:		
Transportation Fund	60,877,000	143,837,100
Veterans Trust Fund	5,300,000	0
Compensation Reserves	78,752,200	133,056,500
Less Lapses	-303,751,800	-342,485,700
Net Appropriations	$14,864,612,700	$15,837,110,700
Balance		
Gross Balance	$725,003,900	$178,139,800
Required Statutory Balance	-65,000,000	-65,000,000
Net Balance, June 30	$660,003,900	$113,139,800

TABLE 2

2013-15 General Fund Fiscal Effects

AB 1 and SB 1 -- Joint Committee on Finance

	2013-14	2014-15
Revenues		
Income Tax Rate Reduction	-$2,100,000	-$96,500,000
Manufacturing and Agriculture Credit	-11,300,000	-24,000,000
Historic Rehabilitation Credit	0	-1,000,000
Research Credit	0	-500,000
Exclusion/Credit for Income From Relocated Business	-110,000	-140,000
Effect on Property Tax/Rent Credits Due to Reduced Property Tax Levies	0	2,640,000
Adjust Withholding Tables	-156,500,000	-166,100,000
Total	-$170,010,000	-$285,600,000
Appropriations, Transfers, and Reserves		
Wisconsin Technical College System Property Tax Relief Aid	$0	$406,000,000
Effect on Homestead Tax Credits Due to Reduced Property Tax Levies	0	-790,000
Effect on Veterans and Surviving Spouses Tax Credits Due to Reduced Property Tax Levies	0	-1,530,000
Total	$0	$403,680,000
Effect on General Fund Balance	**-$170,010,000**	**-$689,280,000**

Biennial Effect on General Fund Balance **-$859,290,000**

General Fund Taxes

1. INCOME TAX RATE REDUCTION

GPR-Tax	- $98,600,000

Reduce the marginal tax rate that applies to income that falls within the bottom income tax bracket of the state's individual income tax from 4.4% to 4.0%, effective with tax years beginning after December 31, 2013, and modify employers' withholding tables to reflect the proposed rate reduction on April 1, 2014. Decrease estimated individual income tax collections by $2,100,000 in 2013-14 and $96,500,000 in 2014-15. The fiscal effect related to the revised withholding tables is reflected in a separate entry. The rate and bracket structures under current law and under the special session bills are shown below.

Tax Year 2014 Tax Brackets			Tax Rates	
Single	Married-Joint	Married-Separate	Current Law	Special Session Bills
Less than $10,910	Less than $14,540	Less than $7,270	4.40%	4.00%
10,910 to 21,820	14,540 to 29,090	7,270 to 14,540	5.84	5.84
21,820 to 240,190	29,090 to 320,250	14,540 to 160,130	6.27	6.27
240,190 and Over	320,250 and Over	160,130 and Over	7.65	7.65

2. MANUFACTURING AND AGRICULTURE CREDIT

GPR-Tax	- $35,300,000

Modify the current law procedures for claiming the manufacturing and agriculture credit so that the credit may be claimed as an offset to both the regular tax and the alternative minimum tax under the individual income tax. These provisions would apply retroactively to tax years beginning on January 1, 2013. Decrease estimated individual income tax collections by $11,300,000 in 2013-14 and $24,000,000 in 2014-15. Due to the credit's phase-in, this provision would reduce estimated individual income tax collections by $39,000,000 in 2015-16 and by $49,300,000 in 2016-17 and thereafter.

The credit was created in 2011 Act 32 and is being phased in between tax years 2013 and 2016. The credit is available to taxpayers to offset the tax on income from manufacturing and agricultural activities in Wisconsin. Currently, individual income tax provisions allow the manufacturing and agriculture credit to be used only to reduce regular tax liability.

3. HISTORIC REHABILITATION CREDIT

GPR-Tax	- $1,000,000

Modify the current law procedures for claiming the state historic rehabilitation credit so that the credit may be claimed as an offset to both the regular tax and the alternative minimum tax. These provisions would first apply in taxable years beginning on January 1, 2014. Decrease estimated individual income tax collections by $1,000,000 in 2014-15.

The historic rehabilitation credit is available to natural persons based on their expenditures for preserving or rehabilitating historic properties that are owner-occupied residences. Under current law, the state historic rehabilitation credit may be used only to reduce regular tax liability under the individual income tax. Wisconsin also offers a separate historic rehabilitation credit for non-residential properties that is a supplement to the federal historic rehabilitation credit. The state supplement to the federal historic rehabilitation credit already may be claimed as an offset to both the regular tax and the alternative minimum tax under the state individual income tax.

4. RESEARCH CREDIT

GPR-Tax	- $500,000

Modify the current law procedures for claiming the research credit so that the credit may be claimed as an offset to both the regular tax and the alternative minimum tax under the individual income tax. These provisions would first apply to taxable years beginning on January 1, 2014. Under current law, the research credit may be used only to reduce regular tax liability under the individual income tax. Decrease estimated individual income tax collections by $500,000 in 2014-15. The research credit is based on the increase in a corporation's qualified research expenditures in Wisconsin, and may be claimed under the individual income tax by taxpayers with an ownership interest in a pass-through business.

The state also offers a research facilities credit based on the expenditures for constructing or equipping new research facilities or expanding existing research facilities. This credit may be claimed under the individual income tax as an offset only to regular tax, and not as an offset to the alternative minimum tax. A third research credit called the super research and development credit is available only to corporations and cannot be claimed on the individual income tax by taxpayers with an ownership interest in a pass-through business. 2013 Act 20 eliminated the research facilities credit and the super research and development credit beginning in tax year 2014.

5. NET BUSINESS LOSS CARRYFORWARDS FOR CORPORATIONS

Extend net business loss carryforwards from 15 to 20 years, for all corporations under the state corporate income/franchise tax, for tax years beginning on or after January 1, 2014.

Under current law, net business losses can be carried forward up to 20 years under the individual income tax, and pre-2009 net business losses of combined groups can also be carried forward up to 20 years under the corporate income/franchise tax. Net business losses that are not pre-2009 losses can be carried forward up to 15 years, under the corporate income/franchise tax. Net business losses cannot be carried back under the corporate income/franchise tax. This provision would allow all net business losses to be carried forward up to 20 years under the state corporate income/franchise tax. Extending net business loss carryforwards to 20 years would have a minimal fiscal effect. A Department of Revenue review of corporate income/franchise tax returns showed that only a small number of corporations had net business loss carryforwards that were older than 15 years.

6. AUTOMATIC FEDERALIZATION OF DEPLETION PROVISIONS

Modify current law to specify that any federal changes to Internal Revenue Code (IRC) provisions related to depletion would be automatically adopted for state individual income and corporate income/franchise tax purposes, in the year in which they were effective.

Under current law, state depletion provisions are referenced to the IRC in effect on January 1, 2014. The provision would modify current law to automatically adopt federal depletion provisions for state income and franchise tax when they are effective under federal law. This provision would have no fiscal effect, unless Congress enacted changes to IRC depletion provisions.

7. NET OPERATING LOSS CARRY BACK

Specify that taxpayers are not required to carry back a net operating loss to the preceding two years if the taxpayer chooses not to do so. Specify that this provision would first apply in taxable years beginning on January 1, 2014. In addition, specify that the Department of Revenue (DOR) may not pay interest on any overpayment of taxes resulting from the carry back of net operating losses, effective on January 1, 2014.

Prior to Act 20, Wisconsin allowed net operating losses to be carried forward for up to 15 years, but did not allow net operating losses to be carried back. Under Act 20, taxpayers are allowed to carry forward net operating losses for 20 years and carry back losses for two years, beginning with tax year 2014. The proposed change clarifies that the Act 20 provision regarding carry backs is permissive and not mandatory. These provisions would decrease estimated individual income tax collections by a minimal amount, beginning in 2014-15.

8. EXCLUSION/CREDIT FOR INCOME FROM RELOCATED BUSINESS

GPR-Tax	- $250,000

Provide that businesses that relocate to Wisconsin in 2013 may claim the business relocation exclusion or tax credit for two years, as described below.

Individual Income Tax Exclusion. Under current law, for taxable years beginning after December 31, 2010, and before January 1, 2014, for two consecutive taxable years beginning with the taxable year in which the claimant's business locates to this state from another state or another country and begins doing business in this state, a business may exclude any profit or loss from a trade or business, plus ordinary gain or loss on the sale of business assets, from state individual income taxes. The January 1, 2014, sunset date for the exclusion was enacted in 2013 Act 20 (the 2013-15 biennial budget)

Under the special session bills, no person could claim this exclusion for taxable years beginning after December 31, 2013, except that a claimant who is first eligible to claim an exclusion beginning after December 31, 2012, and before January 1, 2014, could claim the exclusion the following taxable year. This would allow the two-year exclusion for businesses that first qualify in 2013.

Corporate Income Tax Credit. Current law provides a credit against the claimant's corporate income/franchise tax liability for a business that locates to this state from another state or country, and begins doing business in Wisconsin. The credit equals the amount of tax liability after applying all other allowable credits, deductions and exclusions. The credit can be claimed for two consecutive tax years, beginning with the tax year in which the claimant relocates to Wisconsin.

Under Act 20, the relocated business credit was eliminated for tax years beginning after December 31, 2013. Act 20 also specifies that relocated business credits for taxable years that begin before January 1, 2014, may be carried forward to taxable years that begin after December 31, 2013.

The special session bills would delete the current carry-forward provision for the credit, and instead specify that a claimant who is first eligible to claim a credit for taxable years beginning after December 31, 2012, and before January 1, 2014, may claim the credit in the following taxable year. This would correct a flaw in the current carry-forward statute and allow corporations that first claim the credit in 2013 to receive the credit for two years.

These provisions would reduce state income and franchise tax collections by an estimated $110,000 in 2013-14 and $140,000 in 2014-15.

9. ELECTRONIC MEDICAL RECORDS TAX CREDIT

Provide that the electronic medical records tax credit could not be claimed based on amounts paid after December 31, 2013, even if the taxpayer's 2013 tax year extends into calendar year 2014.

Under current law, for taxable years beginning after December 31, 2011, and before January 1, 2014, a claimant may claim an income or franchise tax credit equal to 50% of the amount the claimant paid in the taxable year for information technology hardware or software that is used to maintain medical records in electronic form, if the claimant is a health care provider. The maximum total amount of credits that can be claimed in a tax year is $10 million.

10. JOBS TAX CREDIT

Provide that in order to claim a jobs tax credit, the claimant would have to increase employment <u>in this state</u> over the base year employment <u>in this state</u>. This provision is intended to clarify that to be eligible for a credit the business must increase employment in Wisconsin, whether by creating new jobs or relocating jobs from another state.

Under current law, among other requirements, in order to be eligible for a jobs credit, a person certified by the Wisconsin Economic Development Corporation must increase net employment in the person's business above the net employment in the person's business during the year before the person was certified.

11. SALES TAX EXEMPTIONS FOR PRINTING INDUSTRY

Make technical modifications to sales and use tax exemptions, as created under 2013 Wisconsin Act 20, for certain items purchased by certain persons primarily engaged in commercial printing. Specify that the proposed modifications would take effect and first apply retroactively to sales made on or after October 1, 2013.

Current Law. Current law provides sales and use tax exemptions for certain items purchased by persons primarily engaged in commercial printing, not including screen printing or book printing, without publishing, except for gray goods; printing, or printing and binding, books or pamphlets without publishing the books or pamphlets; or performing prepress and postpress services in support of printing activities. The exemptions from the tax for the entities described above are for their purchases of:

a. computers and servers that are used to store copies of the product that are sent to a printing press; and

b. tangible personal property purchased from out-of-state sellers that are temporarily stored, remain idle, and are not used in this state for not more than 180 days and that are then delivered and used outside of this state.

These provisions took effect on October 1, 2013.

Proposed Modifications. Specify that the current law exemptions would, instead, be available to persons primarily engaged in, as determined by DOR, commercial printing, book printing, or support activities for printing described under the North American Industry Classification System (NAICS) codes 323111, 323117, and 323120 [The activities identified in these NAICS codes are identical to those that qualify for the exemptions under current law].

Specify that the exemption under "a." would apply to computers and servers used primarily to store copies of the product that are sent to a digital printer, a platemaking machine, or a printing press, or used primarily in prepress or postpress activities. Define "prepress activities" to include making print-ready plates, typesetting, trade binding, and sample mounting. Define "postpress activities" to include paper bronzing, die-cutting, edging, embossing, folding, gilding, gluing, and indexing. The proposed changes would clarify that the computers and servers would have to be primarily used to store copies of product and that the copies would not have to be sent directly to a printing press.

Modify the exemption under "b." to specify that, after storage in Wisconsin, the property must be delivered and used solely outside of this state.

As noted, these changes would take effect and first apply retroactively to sales made on October 1, 2013, which corresponds to the Act 20 starting date for the exemptions. According to DOR, these modifications are expected to have a minimal impact on state tax revenues.

12. HOMESTEAD CREDIT -- LOSS CARRY-BACKS

Specify that loss carry-backs must be added back in computing household income for purposes of the homestead tax credit. Under current law, loss carry-forwards are added back to the claimant's income in calculating household income. The bill would ensure that loss carry-backs are treated the same as loss carry-forwards. Specify that this change would first apply retroactively to taxable years beginning on January 1, 2012. This change would result in a minimal decrease in homestead tax credits.

Wisconsin Technical College System

13. PROPERTY TAX RELIEF AID

GPR	$406,000,000

Provide $406,000,000 in 2014-15 in a new, capped sum sufficient appropriation under the Wisconsin Technical College System (WTCS) for property tax relief aid. Require the state WTCS Board to distribute this aid to each technical college district board beginning on February 20, 2015, and annually thereafter on the third Friday in February. Provide that each district board would receive an amount calculated by: (a) dividing the district's equalized value as of January 1, 2014, by the total equalized value of all districts as of January 1, 2014; and (b) multiplying the quotient determined under (a) by $406,000,000. Provide that equalized value excludes the value of tax incremental districts. Specify that for the payment in 2016 and annually thereafter, each district board would receive the same amount as in 2015. Require the state WTCS Board to notify each district board by October 15, 2014, of the amount of aid it will receive on February 20, 2015.

14. INTERACTIVE EFFECTS DUE TO REDUCED TECHNICAL COLLEGE PROPERTY TAX LEVIES

GPR	- $2,320,000
GPR-Tax	$2,640,000

Decrease estimated GPR expenditures by $2,320,000 and increase estimated individual income tax collections by $2,640,000 in 2014-15 to reflect reduced state tax credit claims resulting from lower property taxes levied by technical college districts under the changes described above. Lower property tax bills will result in smaller estimated state credits claimed under the school property tax/rent credit (-$2,640,000), veterans and surviving spouses property tax credit (-$1,530,000), and the homestead credit (-$790,000). The school property tax/rent credit is a nonrefundable tax credit, so changes in credit amounts affect individual income tax collections (lower credits result in higher tax collections). The veterans and surviving spouses property tax credit and the homestead credit are refundable tax credits and are reflected as expenditures in the state appropriation schedule (lower credits result in reduced appropriations).

15. REPLACE LEVY LIMIT WITH REVENUE LIMIT

Replace the current limit that applies to each technical college district's tax levy with a revenue limit that would apply to the sum of the district's tax levy and the property tax relief aid received by the district under Item #11. As under the current levy limit, tax levy would be defined to exclude taxes levied for the purpose of paying principal and interest on valid bonds and notes, other than noncapital notes issued on or after July 2, 2013. Beginning in the 2014-15 school year and for each school year thereafter, specify that no district board could increase its revenue by a percentage that exceeds the district's valuation factor. As under the current levy limit, valuation factor would be defined as a percentage equal to the greater of either: (a) zero percent; or (b) the percentage change in the district's January 1 equalized value due to the aggregate new construction, less improvements removed, in municipalities located in the district, as determined by the Department of Revenue.

Specify that the current law levy limit provisions related to excess levy, referendum approval needed to exceed the limit, and carry forward of any under levy, would be modified to apply to the proposed revenue limits.

Individual Income Tax Withholding and Budget Stabilization Fund

16. ADJUST WITHHOLDING TABLES

GPR-Tax	- $322,600,000

Section 71.64(9)(b) of the state statutes authorizes DOR to adjust the individual income tax withholding tables to reflect changes in tax rates, the imposition of a surtax, or statutory changes to the brackets. DOR last changed the withholding tables in October, 2009, to reflect the creation of a new top bracket and rate in 2009 Act 28 and to reflect the inflationary effects of indexing. In the past, provisions have been enacted that require DOR to make withholding adjustments or to refrain from making withholding adjustments in response to certain law changes. The bills do not contain a provision requiring DOR to modify the withholding tables, but the Governor has directed DOR to implement withholding changes beginning on or after April 1, 2014. The administration indicates that these changes will reduce estimated individual income tax collections by $156,500,000 in 2013-14 and by $166,100,000 in 2014-15.

From the taxpayer's perspective, the lower amount of withheld income taxes will be exactly offset by a decreased refund or larger payment (remittance) when the taxpayer's return is filed the following spring. However, because of timing differences in state cash flows, the withholding table changes will result in a one-time state revenue loss of approximately $322.6 million in the 2013-15 biennium.

The revenue loss in 2013-14 will occur because withholding taxes will be reduced for three months--from April through June, 2014--with no offsetting reduction in refunds (or increase in remittances) from tax year 2013.

In 2014-15, withholding taxes will be reduced for twelve months, which will be partially offset by lower refunds (and larger remittances) paid in the Spring of 2015. However, the lower refunds will reflect only nine months of reduced withholding taxes in calendar year 2014 (from April through December), which means there will be a second one-time loss in 2014-15. Beginning in 2015-16, the reduced withholding taxes will be offset by lower refunds and higher remittances during the tax filing season.

The Governor directed the DOR Secretary to implement withholding changes in a letter dated January 22, 2014. In making the changes, the letter instructs the Secretary to modify the tables to reflect the inflationary adjustments to the tax brackets and to the sliding scale standard deduction that have occurred under indexing, the tax rate and bracket modifications enacted under 2013 Act 20, and the tax rate reduction proposed in the special session bill(s). The following table reflects the effect of each change.

Estimated One-Time Revenue Reduction Resulting from Withholding Changes
($ in Millions)

Change Due To:	2013-14	2014-15	Biennium
Indexing	-$73.4	-$75.1	-$148.5
Act 20 Rate & Bracket Changes	-61.7	-68.5	-130.2
Proposed Tax Rate Change	-21.4	-22.5	-43.9
Total	-$156.5	-$166.1	-$322.6

17. BUDGET STABILIZATION FUND

Suspend current law provisions regarding transfer to the budget stabilization fund for 2013-14 and 2014-15.

Current law governing transfers from the general fund to the budget stabilization fund specifies that half of any excess of actual general fund tax revenues in a fiscal year over the amount included in the biennial budget act must be deposited into the budget stabilization fund after the close of that fiscal year. The budget stabilization fund currently has a balance of $279.3 million.

Current law further states that if a transfer to the budget stabilization fund would reduce the balance of the general fund below the required statutory reserve, then the transfer must be reduced as needed to maintain the required reserve. The statutory reserve is set at $65 million annually. For example, if the gross balance in the general fund at the end of a fiscal year was $100 million, the most that could be transferred to the budget stabilization fund would be $35 million.

It is estimated that, under AB 1 and SB 1, the current law transfer to the budget stabilization fund for 2013-15 would be $113.1 million. By suspending the transfer for this biennium, the $113.1 million would remain in the general fund.

Required Lapse to the General Fund

18. EXTENSION OF 2013-15 REQUIRED LAPSES

Extend the $38.2 lapse requirement of 2013 Act 20 (the 2013-15 budget) for an additional year to 2015-16.

2013 Act 20 requires the Secretary of the Department of Administration to lapse to the general fund $38.2 million from the unencumbered balances of GPR and PR appropriations of specific state agencies for each of 2013-14 and 2014-15. Lapses cannot be taken from sum sufficient or FED appropriations and the Secretary cannot lapse moneys if the lapse would violate a condition imposed on the expenditure of the moneys by the federal government or the lapse would violate the federal or state constitution. The following table shows the annual lapse amounts by agency.

Annual Lapse Amounts

Agency	Amount
Administration	$13,430,900
Agriculture, Trade and Consumer Prot.	1,664,800
Child Abuse and Neglect Prevention	228,400
Children and Families	592,200
Corrections	1,864,100
District Attorneys	43,300
Educational Communications Board	85,500
Financial Institutions	2,434,400
Government Accountability Board	40,200
Historical Society	11,900
Insurance Commissioner	902,700
Justice	2,040,300
Natural Resources	3,008,000
Public Defender Board	118,700
Public Instruction	1,049,300
Public Service Commission	98,700
Revenue	1,383,400
Safety and Professional Services	6,232,000
Secretary of State	51,200
State Fair Park	6,700
Tourism	10,400
Transportation	140,900
Wisconsin Technical College System	65,100
Workforce Development	2,673,000
Total	$38,176,100

Under AB 1 and SB 1, as recommended by Joint Finance, the lapse amounts shown above would be required for an additional year to 2015-16.