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APPENDIX

Federal Tax Law Changes With a Minimal or No Fiscal Effect

In addition to the provisions described above, the IRC update would adopt a number of other federal law changes that would affect state taxpayers, but would have a minimal state fiscal effect. These provisions are described below.

INDIVIDUAL INCOME TAX

Exclusion for Employer-Provided Adoption Assistance

An employe's gross income will not include amounts paid by an employer for the employe's qualified adoption expenses as part of an adoption assistance program. The amount excluded cannot exceed $5,000 ($6,000 for a special needs child). The exclusion is phased out for taxpayers with AGI between $75,000 and $115,000. The exclusion is not available for amounts paid or expenses incurred after December 31, 2001, for both special needs and non-special needs adoptions.

Qualified adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees, and other expenses that are directly related to, and for the principal purpose of, the legal adoption of a child, including all expenses required by a state as a condition of adoption. The expenses may not be incurred in violation of state or federal law, or incurred under a surrogate parenting arrangement or the adoption of a spouse's child.

Wisconsin currently provides a deduction for adoption expenses of up to $5,000. The Department recommends adopting the federal provision and limiting the state deduction to amounts included in federal AGI. The provision would first be effective for tax years beginning after December 31, 1996, and is estimated to have a minimal impact on state revenues.

Exclusion for Housing for Medical Research Institution Employes

Employes of certain medical research institutions may exclude from income the value of subsidized campus housing as long as they pay annual rent that is at least 5% of the appraised value of the housing or, if market rents are less than that, the average amount paid for comparable housing. If the rent is inadequate, the employe must include in income the difference between the actual rent paid and the rent threshold amount. Qualified campus housing must be located on the campus of the employer or, in the case of state university systems comprised of many institutions with separate campuses, on the campus of one of the component institutions. This exclusion has been available to university employes since 1986.

An eligible medical research institution must be eligible to receive charitable contributions, receive social security payments for graduate medical training and have as one of its principal purposes the providing and teaching of basic and clinical medical science and research.

The Department recommends adopting the provision for tax years beginning on January 1, 1997. This provision is estimated to result in a minimal revenue loss.

Exclusion for Self-Insured Plans

Amounts received by a self-employed individual for a personal injury or sickness are excludable from income when the payment is from a self-insured accident or health plan, effective for tax years beginning after December 31, 1996. This provision is estimated to result in a minimal revenue loss.

Accelerated Death Benefits

Accelerated death benefits received under a life insurance contract on the life of an insured, terminally or chronically ill individual may be excluded from gross income. In addition, amounts received from a viatical settlement provider are excludable. The exclusion is not applicable to amounts paid to any person other than the insured.

A chronically ill individual only may exclude death benefits if the amount is received under a rider or other provision of a contract which is treated as a qualified long-term insurance contract. Payments made on per diem basis are excludable up to $175 per day ($63,875 annually); the maximum amount will be indexed for inflation beginning in 1998.

A terminally ill individual is a person whom a physician has certified as having a condition that is reasonably expected to result in death within 24 months. A chronically ill individual is a person whom a licensed health care practitioner has certified within the preceding 12 months as being unable to perform at least two activities of daily living for a period of 90 days, having a similar level of disability, or requiring supervision for health and safety reasons due to a cognitive impairment.

A viatical settlement provider includes any person that is engaged in the trade or business of purchasing or accepting assignment of life insurance contracts on the lives of terminally or chronically ill insured. The provider must be licensed in the state in which the insured resides.

This provision is effective January 1, 1997. The state currently exempts amounts received under a viatical settlement contract. The Department recommends adopting the provision and limiting the existing state exemption to amounts included in federal AGI. This provision is estimated to have no fiscal impact.

IRA Distributions for Medical Expenses and Health Insurance Premiums

The 10% tax imposed on early distributions from IRAs will not apply to distributions used to pay medical expenses in excess of 7.5% of AGI.

The 10% tax would also not apply for payment of health insurance premiums after separation from employment if the individual has received unemployment compensation for 12 consecutive weeks and if the distributions are made during the tax year the compensation is paid or during the following tax year. This exception would not apply to distributions made after the individual has been employed for at least 60 days. A self-employed person is considered to have met the unemployment compensation requirements if the individual would have received compensation except for the fact of being self-employed.

This provision is effective for distributions made after December 31, 1996. Generally, under current law, if the federal 10% tax is imposed for each distribution from an IRA, the state imposes a tax equal to 33% of the federal tax. Adopting this provision is estimated to result in a minimal loss of revenues.

Self-Employed Health Insurance Deduction

Under prior federal law, self-employed persons were entitled to deduct 30% of amounts paid for health insurance for themselves, their spouse and their dependents. This deduction will be increased to 40% in tax year 1997 and to 45% in tax years 1998 through 2002. In 2003, the deduction is 50% and is increased by 10% each year, beginning in 2004, until the maximum of 80% is reached for 2006 and thereafter. The self-employed insurance deduction is also expanded to include long-term care insurance premiums.

This provision is effective with tax years beginning after December 31, 1996. The provision allowing self-employed individuals to deduct long-term care insurance premiums would result in a minimal revenue loss. Increasing the federal exclusion for health insurance would have no impact since Wisconsin currently allows self-employed individuals to deduct 100% of health insurance premiums.

Long-Term Care Services and Insurance Premiums

Unreimbursed amounts paid for long-term care services provided to a taxpayer, the taxpayer's spouse or dependents are treated as medical expenses for purposes of the medical expense itemized deduction. Amounts paid for services provided by a relative, either directly or indirectly, are not counted as a deductible medical expense, unless the relative is a licensed professional. Long-term care insurance premiums that do not exceed the following annual limitations are also treated as medical expenses for the deduction (these amounts will be adjusted for inflation after 1997): $200 if age 40 or less, $375 up to age 50, $750 up to age 60, $2,000 up to age 70, and $2,500 if over age 70.

For federal tax purposes, medical expenses are deductible from income to the extent that the expenses exceed 7.5% of AGI and if total itemized deductions exceed the standard deduction.

This provision is effective for tax years beginning after December 31, 1996. The Department recommends adopting this provision for purposes of calculating the state's itemized deduction tax credit. This provision is estimated to result in a minimal loss in revenues.

Alternative Minimum Tax: Residual REMIC Interest

Three rules were provided for determining the alternative minimum taxable income (AMTI) of a taxpayer who holds residual interests in a real estate mortgage investment trust (REMIC). These rules, which do not apply to thrift institutions, would:

a. Prevent a taxpayer from having to include preference items for which no tax benefits were received by computing AMTI without regard to the rule that taxable income cannot be less than the amount of excess inclusions;

b. Prevent nonrefundable credits from reducing the taxpayer's income tax below an amount equal to what the tentative minimum tax would be if computed only on excess inclusions by specifying that the AMTI of a taxpayer cannot be less than the excess inclusions of REMIC.

c. Ensure that net operating losses do not reduce any income attributable to excess inclusions, allowing a taxpayer subject to the alternative minimum tax to pay a tax on excess inclusions at the AMT rate, regardless of whether the taxpayer has a net operating loss.

This provision is effective for tax years beginning after December 31, 1986, unless a taxpayer elects to apply the provisions only to tax years beginning after August 20, 1996. This provision is estimated to result in a minimal loss in revenues.

EARNED INCOME TAX CREDIT

Phase-Out Based on Modified Adjusted Gross Income

For credit claimants with an AGI greater than phase-out income, the credit is based on the greater of earned income or AGI. Beginning with tax year 1996, the AGI measure is modified by adding back certain losses: (a) net capital losses if greater than zero; (b) net losses from trusts and estates; (c) net losses from nonbusiness rents and royalties; and (d) 50% of the net losses from business (unless the loss is from the performance of services as an employe).

For claimants receiving the advance federal EITC as of June 26, 1996, this provision is effective for tax years beginning after December 31, 1996. For all other recipients, the effective date is for tax years beginning after December 31, 1995. Since the state credit is calculated as a percentage of the federal EITC, the modified AGI provision is currently part of the base for tax year 1996 and thereafter. Therefore, no additional fiscal effect is estimated.

Definition of Disqualified Income

The credit is denied to individuals with disqualified income in excess of $2,200. Disqualified income is defined as taxable and nontaxable interest income, dividends, net income from rents and royalties not derived in the ordinary course of business, capital gain net income and net passive income (if greater than zero) that is not self-employment income. The $2,200 amount will be indexed for inflation after 1996.

For claimants receiving the advance federal EITC as of June 26, 1996, this provision is effective for tax years beginning after December 31, 1996. For all other recipients, the effective date is for tax years beginning after December 31, 1995. Since the state credit is calculated as a percentage of the federal EITC, the disqualified income provision is currently part of the base for tax year 1996 and thereafter. Therefore, no additional fiscal effect is estimated.

ESTATE AND GIFT TAXES

Special Valuation Rules

Special rules apply for valuing the rights retained in conjunction with the transfer of interest in a corporation or partnership to an applicable family member. The rules apply to retained interest with respect to liquidation, put, call or conversion rights. The special valuation rules are only in effect when the retained interest allows the right to receive payment, but does not actually involve a liquidation, put, call or conversion. Retained interest in the form of distribution rights held as a junior equity interest position are also subject to the rules. In order for the rules to apply, the transfer must be to an applicable family member which includes any lineal descendant of any parent or the transferor or the transferor's spouse. All rights under this provision are valued at zero.

This provision is effective for transfers after October 8, 1990, and is estimated to result in a minimal revenue loss.

Unified Credit Required by Treaty

Federal law clarified that property exempted by treaty from U.S. estate tax is not treated as situated in the U.S. when determining the pro rata unified credit for decedents dying with property in more than one country. This prevents the estate from using exempt property as an advantage when calculating the pro rata unified credit. This provision is effective August 20, 1996, and is estimated to result in a minimal increase in revenues.

ESTATES AND TRUSTS

Foreign Nongrantor Trusts

The Secretary of the Treasury is authorized to issue regulations that apply to estates, trusts and beneficiaries, including rules to prevent abusive transactions. A loan of cash or marketable securities by a foreign nongrantor trust to a U.S. grantor or beneficiary is treated as distributed. Exceptions are provided, including where the loan is structured with arm's-length terms.

The abusive transaction provision is effective August 20, 1996; the loan provision applies after September 19, 1995. These provisions are estimated to result in a minimal increase in revenues.

Inbound Foreign Grantor Trusts

To prevent tax avoidance through the use of foreign grantor trusts, the U.S. grantor trust rules generally do not apply to any portion of a trust that would otherwise be deemed to be owned by a foreign person. Rather, the rules are generally applied when they result in amounts being taken into account in computing the income of a U.S. citizen, resident or corporation.

Exceptions are provided for: (a) revocable trusts where the power to revoke is exercisable solely by the grantor and not conditioned on approval or consent of any person; (b) trusts where distributions of income or corpus during the grantor's lifetime are only distributable to the grantor or spouse; (c) trusts established to pay compensation for services rendered; and (d) trusts owned by the grantor, another person or trusts from which income is distributed or held for distribution only to the grantor or spouse, that are in existence on September 19, 1995.

This provision is effective August 20, 1996, and is expected to result in a minimal increase in revenues.

Outbound Foreign Grantor Trusts

The grantor of a foreign trust with U.S. beneficiaries that received transfers of property by a U.S. person will not be treated as an owner of the trust if the trust paid fair market value to the transferor for the property. Obligations issued by the trust, any grantor or beneficiary, or any related person are generally not taken into account when applying this exception; any obligation that bears arm's-length terms would qualify for the exception. These rules do not apply to transfers to a charitable trust.

A foreign grantor who becomes a U.S. resident within five years of transferring property to a foreign trust is treated as transferring the property on the date of the grantor's residency. A U.S. citizen or resident who transfers property to a trust that becomes a foreign trust is treated as transferring property to a foreign trust on the date it became a foreign trust. Beneficiaries are not treated as a U.S. beneficiary if they first became a U.S. person (described below) more than five years after the date of the transfer.

This provision is first effective for transfers of property after February 6, 1995, and is estimated to have a minimal fiscal effect.

Residence of Foreign Trust

A trust is treated as a U.S. person if: (a) a U.S. court can exercise primary supervision over administration of the estate or trust; and (b) one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust. Currently, no guidance on residency is provided.

If a domestic trust changes its situs and becomes a foreign trust, a 35% excise tax is imposed on transfers intended to avoid tax (because the change in situs transfers all trust assets), unless an exemption applies. Information reporting may also be required.

The residence determination provision applies to tax years beginning after December 31, 1996; a trust may make an irrevocable election to apply the provision to tax years ending after August 20, 1996. The excise tax applies on August 20, 1996. These provisions are estimated to result in a minimal gain in revenues.

EMPLOYMENT TAXES

Fishing Crew Members

A measuring standard is established for determining the usual size of the crew of a fishing vessel, which is used to determine whether the crew members are classified as employes or as independent contractors. This change is effective for remuneration paid after December 31, 1994, and for remuneration paid after December 31, 1984, and before January 1, 1995, unless the payor treated such payments as subject to FICA taxes. This provision would result in a minimal revenue loss.

S CORPORATION SIMPLIFICATION

Permissible Number of Shareholders

The maximum number of eligible shareholders of an S Corporation is increased from 35 to 75. This provision is effective for tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Electing Small Business Trusts

A small business trust may be a shareholder in an S corporation if all beneficiaries of the trust are individuals or estates eligible to be S corporation shareholders (except charitable organizations may hold contingent remainder interests). For a small business trust to be eligible, no interest in the trust may be acquired by purchase, but rather by gift, bequest or non-purchase acquisition. Each potential current beneficiary of the trust is counted as a shareholder for the 75 shareholder limitation.

The portion of the trust that consists of stock in one or more S corporations is treated as a separate trust for income tax purposes. Taxable income includes: income, loss or deduction allocated to the trust; gain or loss from the sale of the S corporation stock; any state or local income taxes and administrative expenses of the trust that are properly allocable to the stock; and allowable capital losses to the extent of capital gains. No income tax deduction is allowed for amounts distributed to beneficiaries. This income is not included in the distributable net income of the trust.

When all or a portion of the trust is terminated, any unused loss carryovers or excess deductions are taken by the entire trust. Items included in the S corporation part of the trust are disregarded in determining the tax liability of the remaining part of the trust. The trust's distributable net income does not include any income attributable to the S corporation stock. If a trust is terminated before the end of the S corporation's tax year, the trust must prorate the S corporation items for its final year.

This provision is effective for tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Tax-Exempt Organizations

Certain tax-exempt organizations (qualified retirement plans and charitable organizations) are eligible S corporation shareholders. All items of income, loss, credit or deduction are used in computing the unrelated business taxable income of the tax-exempt organization shareholders and will flow through to the tax-exempt shareholder.

Determinations of the long-term capital gain, if charitable contributions of S corporation stock had been sold by the contributor, are made under rules similar to those relating to unrealized receivables and inventory items of a partnership. Rules relating to employe stock ownership plans do not apply to S corporations.

This provision is effective beginning with tax years after December 31, 1996, and is estimated to result in a minimal revenue loss.

Post-Death Holding Period for Trusts

The post-death holding period of S corporation stock of a grantor trust is expanded from 60 days to two years, beginning on the day of the grantor's death. A trust that becomes an S corporation shareholder pursuant to the terms of a will is permitted to be an S corporation shareholder for two years, beginning on the date of transfer.

This provision is effective for tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Financial Institutions Allowed as S Corporations

Certain financial institutions that do not use the reserve method of accounting for bad debts may elect to be S corporations. This provision is effective with tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Financial Institutions Permitted to Hold Safe Harbor Debt

The definition of straight debt is expanded for purposes of certain safe harbor determinations to include debt held by non-individual creditors that are actively and regularly engaged in the business of lending money, if the straight debt is not treated as a disqualifying second class of stock.

The provision is first effective with tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Ownership of Subsidiaries

An S corporation may own 80% or more of the stock of a C corporation. Dividends received by an S corporation from a C corporation subsidiary are not treated as passive investment income to the extent the dividends are attributable to the earnings and profits of the C corporation derived from the active conduct of a trade or business. The S corporation cannot file a consolidated return with its affiliated C corporation.

An S corporation is permitted to own a qualified subchapter S subsidiary (QSSS), including any domestic corporation that qualifies as an S corporation and is 100% owned by an S corporation parent. A QSSS is not treated as a separate corporation from the parent.

This provision is effective with tax years beginning after December 31, 1996. The IRC update would include specifying that the election to be treated as a QSSS for federal purposes also applies for state purposes and that if an S corporation parent or subsidiary has nexus in Wisconsin then all related corporations have nexus. This provision is estimated to result in a minimal revenue loss.

Inadvertent Terminations and Invalid Elections

The authority of the IRS to waive the effect of an inadvertent termination is extended to cover additional situations. The effect of an invalid election may be waived if caused by the inadvertent failure to qualify as a small business corporation or to obtain required shareholder consents. Late-filed S corporation elections may be treated as timely for reasonable cause.

This provision is effective for elections for tax years beginning after December 31, 1982, and is estimated to result in a minimal revenue loss.

Agreement to Terminate Year

The election to close the books of an S corporation upon the termination of a shareholder's interest is made by the corporation and all affected shareholders, rather than by all shareholders. If the election is made, the closing of the books only applies to affected shareholders. "Affected shareholders" is defined as any shareholder whose interest is terminated and all shareholders to whom the terminating shareholder has transferred shares during the year.

This provision is effective with tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Post-Termination Periods

The post-termination transition period is expanded for a former S corporation to include a 120-day period that begins on a final disposition of a claim for refund by the Secretary of the Treasury and certain other agreements. The change allows distributions by a former S corporation during its post-termination period to be treated as if the termination were made by an S corporation and distributions after the post-termination period are treated as made by a C corporation.

The provision is effective for tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Five-Year Retroactive Re-election Period

Any small business corporation that terminated its subchapter S election within the five-year period immediately preceding August 20, 1996, can re-elect subchapter S status without the IRS's consent. This provision is effective for terminations occurring in a tax year beginning before January 1, 1997, and is estimated to result in a minimal revenue loss.

Carryovers into Post-Termination Period

Losses of an S corporation that are suspended pursuant to at-risk rules may be carried forward to the S corporation's post-termination period, effective with tax years beginning after December 31, 1996. This provision is estimated to result in a minimal revenue loss.

Distributions During Loss Years

Basis adjustments for distributions made by an S corporation during the tax year are taken into account before applying the loss limitation. As a result, distributions reduce the adjusted basis for determining the allowable loss for the year, but that loss does not reduce the adjusted basis for purposes of determining the tax status of the distributions. The amount in the accumulated adjustments account is computed without regard to net negative adjustments when determining the tax treatment of distributions which have accumulated earnings and profits. This provision treats the distributions by an S corporation during a loss year the same as for partnerships.

This provision is effective with tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue gain.

Inherited S Corporation Stock

Any person who acquired stock in an S corporation by reason of bequest, devise or inheritance must treat the pro rata share of income of the corporation of the decedent as income acquired directly from the decedent. An estate tax deduction is allowed attributable to the income. The stepped-up basis of the stock acquired from a decedent is reduced to the extent that the value of the stock is attributable to income in respect to the decedent. This provision treats S corporation shareholders the same as partners under partnership rules.

This provision is effective with decedents dying after August 20, 1996, and is estimated to result in a minimal revenue gain.

Subdivided Real Estate

S corporations may qualify for capital gain presumptions that permit capital gain treatment for unimproved subdivided real property held for five years that would otherwise constitute ordinary income property. Previously, this treatment was only available to non-corporate taxpayers. This provision is effective with tax years beginning after December, 31, 1996, and is estimated to result in a minimal revenue loss.

PENSIONS

Tax-Exempt Organizations

Tax-exempt organizations are allowed to established 401(k) plans for their employes. This provision is effective with years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Church Pension Plans

Self-employed ministers and ministers who are employed by organizations that are not tax-exempt entities may participate in church plans. A self-employed minister is treated as a tax-exempt organization. Contributions made by ministers to church plans are deductible. Compensation that is used for purposes of determining contributions for a church plan may not be used in determining contributions for a non-church plan.

No employe will be treated as an officer, shareholder, supervisory employe or highly compensated employe unless that person also satisfies the Employee Retirement Income Security Act (ERISA) definition of highly compensated employe. Church plans are required to use the same definition of highly compensated employes that is applicable to other pension plans.

Contributions made by employers on behalf of foreign missionaries are includible in the missionaries' basis in the plan.

These provisions are effective with years beginning after December 31, 1996, and are estimated to result in a minimal revenue loss.

Simplified Distribution Rules

Lump-Sum Distributions. Five-year forward averaging for lump-sum distributions is repealed for tax years beginning after December 31, 1999. Laws that apply to individuals who attained age 50 before January 1, 1986, are still in effect (these laws allow an individual, trust or estate to elect 10-year forward averaging for a single lump-sum distribution and capital gains treatment for the pre-1974 portion of a lump-sum distribution regardless if the employe is age 59½).

Death Benefits Exclusion. A provision that allowed a beneficiary or estate of a deceased employe to exclude up to $5,000 in benefits paid by or on behalf of an employer by reason of the employe's death is repealed for decedents dying after August 20, 1996.

Annuity Contracts. A simplified method for determining the portion of an annuity distribution plan that represents nontaxable return of basis was provided. The portion of each annuity payment that represents nontaxable return of basis is generally equal to the employe's total investment in the contract as of the annuity starting date, divided by the number of anticipated payments, which are determined by the age of the participant as follows: 360 payments if age 55 or under; 310 payments if age 56 through 60; 260 payments if age 61 through 65; 210 payments if age 66 through 70; and 160 payments if age 71 and over. If the number of payments is fixed in the annuity, that number is used instead.

The investment in the contract is the amount of premiums and other consideration paid minus the amount received before the annuity starting date that was excluded from gross income.

This simplified method does not apply if the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than five years of guaranteed payments under the annuity. If a person receives, in connection with commencement of annuity payments, a lump-sum payment that is not part of the annuity stream, this payment is taxed as if it was received before the annuity starting date. The investment in the contract used to calculate the simplified exclusion ratio for the annuity payment is reduced by the amount of the payment.

This provision is effective with annuity starting dates later than 90 days after August 20, 1996.

Determination of Unrecovered Investment in Annuity Contract. The entire investment in an annuity contract with a refund feature may be recovered tax free in the event that annuity payments cease because of the death of the annuitant. Previously, the investment in the contract that could be recovered was reduced by the present value of the refund. This provision applies to individuals whose annuity starting date is after December 31, 1986.

New Required Beginning Date for Distributions. Participants in qualified plans, with the exception of 5% owners and IRA holders, are no longer required to begin receiving distributions after attaining age 70½ if still employed. Distributions must begin by April 1 of the calendar year following the later of the year in which the employe reaches 70½ or retires. The accrued benefit must be actuarialy increased to reflect the value of benefits that would have been received if benefits had begun at age 70½. This provision is effective for years beginning after December 31, 1996.

The simplified distribution rules are estimated to result in a minimal revenue gain.

Nondiscrimination Rules

Highly Compensated Employes and Family Aggregation Rules. An employe is considered highly compensated if the individual was a 5% owner during the current or preceding year or had compensation in excess of $80,000 during the prior year and, if the employer elects, was in the top 20% paid group of the employer. An employer may be able to designate those employes with higher benefit percentages as being non-highly compensated. The $80,000 amount will be indexed for inflation. The rule requiring the highest paid officer to be treated as a highly compensated employe is repealed.

Family aggregation rules are eliminated. These rules required that compensation paid to family members of certain highly compensated employes was treated as paid to or on behalf of the employe.

This provision is effective beginning after December 31, 1996.

Application Participation Requirements. A defined benefit plan must benefit at least the lesser of: (a) 50 employes; or (b) the greater of 40% of all employes or two employes (or one if only one employe). This rule may be applied separately to different lines of business with the same employer. This provision is effective for tax years beginning after December 31, 1996.

401(k) Plan Nondiscrimination Rules. A 401(k) plan satisfies the nondiscrimination rules if it meets a notice requirement and one of two contribution requirements. The notice requirement is met if each eligible employe is given written notice of rights and obligations under the plan. The notice must be within a reasonable period, accurate, comprehensive and understood by the average eligible employe. The contribution requirement is met if: (a) the employer makes a matching contribution of 100% of the employe's elective contribution up to 3% of compensation and 50% of employe's elective contributions that exceed 3% of compensation, not to exceed 5%; or (b) the employer makes nonelective contributions of at least 3% of an employe's compensation to a defined contribution plan on behalf of each non-highly compensated employe, regardless if the employe makes elective contributions. Under the matching rule, the match rate for highly compensated employes cannot exceed the match rate for non-highly compensated employes.

A safe harbor method of satisfying the nondiscrimination test is met if the plan meets the contribution and notice requirements and satisfies a special limitation on matching contributions. The special limitation is met if: (a) matching contributions are not made in excess of 6% of compensation; (b) the rate of an employer's matching contribution does not increase as the rate of employe's contributions increases; and (c) the matching rate for highly compensated employes is not greater than the rate for other employes.

Nondiscrimination testing may be done by reference to prior year data. An employer is allowed to elect to use current year data, but that election can be revoked by the Secretary of the Treasury.

Excess contributions are to be considered attributable first to highly compensated employes with the greatest dollar amount of elective deferrals, rather than those with the highest actual deferral percentages.

These provisions are effective for years beginning after December 31, 1998. However, the provisions regarding the use of prior year data and the distribution of excess contributions are effective for years beginning after December 31, 1996.

Compensation for Limits on Contributions and Benefits. For purposes of limits on contributions and benefits under defined contribution plans, the definition of compensation is amended to include: (a) elective deferrals to 401(k) plans and other similar arrangements; (b) elective contributions to nonqualified deferred compensation plans; and (c) salary reduction contributions made to a cafeteria plan. This provision is effective for years beginning after December 31, 1997.

Social Security Retirement Age. Qualified plans are permitted to continue to base benefits on the Social Security retirement age without failing nondiscrimination tests. This provision applies to years beginning after December 31, 1996.

Alternative Nondiscrimination Rules. A 401(k) plan may elect to disregard non-highly compensated employes before they complete one year of service and reach age 21. To make this election, the plan must satisfy the minimum coverage rules taking into account only those employes who have not met the minimum age and service requirements.

A plan can adopt a single actual deferral percentage test that compares deferrals of highly and non-highly compensated eligible employes. A similar rule applies for a actual contribution percentage test.

These provisions are effective for plan years beginning after December 31, 1998. The provisions regarding nondiscrimination rules are estimated to result in a minimal revenue loss.

State and Local Government Deferred Compensation Plans

A state or local deferred compensation plan may allow participants with accounts of \$3,500 or less to elect an in-service cash-out distribution without subjecting the total account to tax. The amount can only be distributed two years after the last deferral and the participant must have not received any other distributions.

A participant may make one election to defer commencement of distributions if made before distributions begin and after the participant attains age 70½, separates from service or experiences an unforeseeable emergency. The maximum deferral amount is the lesser of \$7,500 or one-third of compensation. The amount will be adjusted for inflation in \$500 increments

This provision is effective with tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Limits on Compensation and Benefits of Governmental Plans

The rule limiting a defined benefit plan distribution to 100% of a participant's average compensation for the three highest years is inapplicable to governmental plans; these distributions are limited to $120,000 per year, indexed for inflation. Nongovernmental distributions remain limited to the lesser of $120,000 or 100% of average compensation.

State and local governments may maintain qualified excess benefits plans, subject to the same rules as private employer excess benefit plans. However, participants under such plans may not participate in deferred compensation plans. Certain limits do not apply to disability and survivor benefits and a deadline for revocation of a grandfather rule election is established.

This provision is effective beginning after December 31, 1994, except the deadline for revocation of a grandfather rule election is effective for revocations adopted after August 20, 1996. This provision is estimated to result in a minimal revenue loss.

State and Local Governments Length of Service Awards

Requirements for deferred compensation plans for state and local governments do not apply to plans paying awards, based solely on length of service, to bona fide volunteers, such as firefighters, emergency medical and ambulance service personnel, or their beneficiaries. The same rules apply to vacation leave. The length of service award does not qualify for this treatment if the total award exceeds $3,000 for the year. Exempted amounts are not considered wages for social security taxes.

This provision is effective after December 31, 1995, for accruals of length of service. The exemption from social security taxes applies to remuneration paid after December 31, 1996. This provision is estimated to result in a minimal revenue loss.

Vesting Rules for Multiemployer Plan

Multiemployer plans are subject to the same vesting rules that apply to single-employer plans. Multiemployer plans must provide that a participant's accrued benefits are fully vested after five years; previously, accrued benefits were vested after 10 years for employes covered under a collective bargaining agreement. This provision is effective for plan years beginning on or after the later of January 1, 1997, or the date on which the last collective bargaining agreement under which the plan is maintained terminates, but no later than January 1, 1999. This provision is estimated to result in a minimal revenue loss.

Football Coaches Plan

A qualified football coaches plan will be treated as a multiemployer collectively bargained plan and may include a qualified cash or deferred arrangement. This allows the American

Football Coaches Association to establish 401(k) plans for its members. This provision is effective for years beginning after December 22, 1987, and is estimated to result in a minimal revenue loss.

Multiple Salary Reduction Agreements

A law that barred tax-sheltered annuity participants from entering into more than one salary reduction agreement is repealed, allowing such participants to be treated as 401(k) participants. This provision is effective for tax years beginning after December 31, 1995, and is estimated to result in a minimal revenue loss.

Indian Tribal Government Plans

Any tax-sheltered annuity contract purchased in plan years beginning before 1995 by an Indian tribal government is treated as purchased by an entity permitted to maintain a tax-sheltered annuity plan. Rollovers may be made to 401(k) plans maintained by the tribal government. This provision is effective August 20, 1996, and is estimated to result in a minimal revenue loss.

Distributions Under Rural Cooperative Plans

A rural cooperative plan that includes a cash or deferred arrangement (CODA) may permit distributions to plan participants after they reach age 59½ or on account of hardship, allowing such plans to be treated the same as other CORAs. The definition of a rural cooperative is expanded to include certain public utility districts that provide electric service.

The distribution provision is effective for distributions made after August 20, 1996; the definition change is effective for plan years beginning after December 31, 1996. These provisions are estimated to result in a minimal revenues loss.

Combined Plan Limit

The overall limit is repealed on annual contributions made on behalf of an employe who participates in both a defined contribution plan and a defined benefit plan. The 15% excise tax on excess distributions, those exceeding $155,000 per year or lump sums exceeding $775,000, is suspended until the repeal of the limit takes effect.

Repeal of the combined plan limit takes effect for limitation years beginning after December 31, 1999; suspension of the excise tax is effective for years beginning after December 31, 1996. This provision is estimated to result in a minimal revenue loss.

Actuarial Assumptions in Computing Maximum Benefits

If a benefit is payable before age 62 in a lump sum, the interest rate used to reduce the dollar limit on benefits cannot be less than the greater of the interest rate required by the General Agreement on Trade and Tariffs (GATT) or the rate specified in the plan. The effective date of the new interest rate and mortality assumptions that are used to calculate the limits on benefits and contributions is conformed to the effective date of the provision relating to the calculation of lump sum distributions. Transition rules are provided for plans adopted and in effect before December 8, 1994.

This provision is effective for plan years and limitation years beginning after December 31, 1994, and is estimated to result in a minimal revenue loss.

Contributions on Behalf of Disabled Employes

An employer is no longer required to make a special election in order to continue making deductible contributions to a defined contribution plan on behalf of an employe who is permanently and totally disabled. However, the plan must provide for the continuation of contributions for all participants who are permanently and totally disabled. This provision is effective with years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Definition of Leased Employes

An employer will not be required to treat an individual as a leased employe unless the individual's services are performed under the "primary direction or control" of the recipient employer. The prior test that the individual perform services that were "historically performed" by employes is repealed. Leased employes are eligible for benefits provided by an employer, and the revised definition reduces the risk that an individual for whom the employer contracts for services will be eligible for benefits.

This provision is effective for years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

Reemployment Rights of Veterans

Qualified retirement plans may allow veterans returning to employment from military service to make up employe contributions and elective deferrals that were not made during the employe's military service without risking disqualification for violating contribution and deferral limits. Employers may make matching contributions at the rate that would have applied. Plans must permit reemployed veterans to make elective deferrals for the lesser of five years or the period of military service multiplied by three, beginning with the date of reemployment.

This provision is effective December 12, 1994, and is estimated to result in a minimal revenue loss.

CORPORATE AND BUSINESS TAXES

Involuntary Conversion Rules for Presidentially-Declared Disasters

Expand the involuntary conversion rules to allow business or investment property that is converted compulsorily or involuntarily as a result of a post-1994 Presidentially-declared disaster to be treated as similar or related in service or use to any tangible personal property of a type held for productive use in a trade or business. Under this rule, a taxpayer may elect not to recognize gain with respect to the involuntarily converted property if the tangible business or investment property is acquired within a certain time period.

The provision applies to tax years ending after Presidential declarations of disasters made after December 31, 1994, and would reduce state revenues by an estimated minimal amount.

Involuntary Conversion Basis Rules--Stock Purchases

Modify the involuntary conversion basis rules. When a taxpayer acquires control of a corporation owning property that is intended to replace the taxpayer's involuntarily converted property, and this taxpayer is required to reduce the basis of the acquired corporation's stock, the corporation must also reduce the adjusted basis of its assets by the same amount. The taxpayer's basis is decreased by the amount of any unrecognized gain from the involuntary conversion.

The adjusted basis of the corporation's assets will not be reduced, in the aggregate, below the taxpayer's basis in the stock, as determined after the appropriate stock basis adjustment. In addition, the basis of any individual asset will not be reduced below zero. The basis reduction is first applied to property that is similar or related in service or use to the involuntarily converted property, in proportion to the adjusted basis of the assets in this group. The reduction is then applied to other depreciable property, in a similar manner, and, finally, it is applied to any remaining property in the same manner.

The provision is effective for involuntary conversions occurring after August 20, 1996. The estimated state fiscal effect would be a minimal revenue gain.

Priority for Earnings Strippings Limits on Interest Deductions

A corporation must apply earnings strippings limits to interest expense deductions before applying at-risk and passive activity limits. Earnings strippings rules apply when a corporation has paid or accrued interest to certain related exempt persons. This provision nullifies a proposed

IRS regulation that would have applied earnings strippings rules after the at-risk and passive activity limits.

The provision is effective for interest paid or accrued in tax years beginning after July 10, 1989. It is estimated that it would result in a minimal state revenue loss.

Dues Paid to Agricultural or Horticultural Organizations

Annual dues not exceeding $100 that are paid to a tax-exempt agricultural or horticultural organization are exempt from the unrelated business income tax. The $100 amount will be indexed for inflation in tax years beginning in a calendar year after 1995.

The provision applies retroactively for tax years beginning after December 31, 1986. A transitional rule also excludes dues paid in any tax year beginning before January 1, 1987, from treatment as unrelated business taxable income if the organization to which the dues were paid did not treat any portion of its membership dues as derived in an unrelated trade or business, and it had a reasonable basis for doing so. The provision is estimated to result in a minimal state revenue loss.

Insurance Income of Controlled Foreign Corporations

A new look-through rule applies in characterizing certain insurance income of a controlled foreign corporation for unrelated business income tax (UBIT) purposes. Insurance income earned by a controlled foreign corporation and includible in the income of a U.S. shareholder is not automatically characterized as dividends for UBIT purposes when the shareholder is a tax-exempt organization. Instead, the insurance income is treated as income from an unrelated trade or business to the extent that it would be characterized that way if the tax-exempt organization had received the income directly.

The new look-through rule does not apply to the insurance income that is attributable to the insurance risks of the tax-exempt organization itself, certain tax-exempt affiliates, or an individual who performs services for these affiliates, provided that the insurance covers primarily risks associated with the performance of these services. When a controlled foreign corporation insures the risks of more than one shareholder, one or more of which is a tax-exempt organization, exceptions from the look-through rule are applied on a shareholder-by-shareholder basis.

This provision is effective for amounts includible in gross income for tax years beginning after December 31, 1995. It is estimated that the provision would result in a minimal state revenue loss.

Common Trust Funds

Assets may be transferred from a bank's common trust fund to a regulated investment company (RIC) on a tax-free basis. If a common trust fund transfers substantially all of its assets to one or more RICs solely in exchange for their shares, and then distributes the RIC shares to the fund's participants in exchange for their interests in the fund, no gain or loss is recognized by the fund or its participants. It is intended that the transfer of assets by the common trust fund to one or more RICs and the distribution of RIC shares to participants be made contemporaneously or pursuant to a single plan. Assumption of fund liability by an RIC and property transferred by a fund that is subject to liability are disregarded in determining whether a fund transfer is solely in exchange for RIC shares.

Generally, the RICs receive a carry-over basis on any assets transferred from the common trust fund. However, to the extent that the RIC assumes liabilities of the trust fund in excess of the fund's aggregate basis, the fund will recognize gain in the amount of the excess, and the RIC's basis will be increased by the amount of the recognized gain. The basis of RIC stock for fund participants is the same as the basis in the common trust fund immediately before the transfer but adjusted for recognized gain. If the assets of the fund are transferred to more than one RIC, any increase in basis is allocated in proportion of the fair market values of the assets received by each RIC.

The nonrecognition rule applies to a common trust fund that does not have more than 25% of the value of its total assets invested the stock or securities of one issuer, and does not have more than 50% of the value of its total assets invested in stock or securities of five or fewer issuers. Government securities are not considered securities of an issuer and are excluded in determining total assets.

The provision is effective for transfers by common trust funds after December 31, 1995. The estimated state fiscal effect would be a minimal revenue loss.

Water Utilities Contributions in Aid of Construction

A regulated public utility that provides water or sewage disposal services is permitted to treat any amount of money or property received from any person as a tax-free contribution to its capital if it: (a) is a contribution in aid of construction; (b) is not included in the taxpayer's rate base for rate-making purposes; and (c) is property, other than water or sewage disposal facilities, that meets an expenditure rule.

A contribution meets the expenditure rule and will not be includible in the utility's gross income if: (a) an amount equal to the amount of the contribution is spent for the acquisition or construction of tangible property used predominantly in the trade or business of furnishing water or sewage disposal services; (b) the expenditure occurs before the end of the second tax year after the year in which the contribution was received; and (c) certain records are kept concerning the contribution and expenditure.

The statute of limitations for assessing deficiencies attributable to contributions extends for three years from the date the IRS is properly notified of the expenditures. The basis of any property acquired with a contribution in aid of construction is $0.

The provision is effective for amounts received after June 12, 1996. The state fiscal effect would be an estimated minimal revenue loss.

Definition of Section 179 Property

Certain property that was previously eligible for expensing in the year it was placed in service is no longer eligible for such treatment. Generally, this property includes property used outside the U.S., property used in connection with furnishing lodging, property used by tax exempt organizations, governments and foreign persons, and air conditioning or heating units.

The provision is effective for property placed in service in tax years beginning after December 31, 1990. It is estimated that there would be a minimal revenue gain if the provision is adopted for state tax purposes.

Gasoline Convenience Store Depreciation

For depreciation purposes, depreciable real property that is a retail motor fuels outlet is 15-year property and, for the purposes of the alternative depreciation system, a retail motor fuels outlet has a twenty-year class life. Real property qualifies as a retail motor fuels outlet if either 50% or more of the gross revenues are generated from petroleum sales or 50% or more of the floor space is devoted to petroleum marketing sales. Determination of whether either of the tests are met is based on an IRS Coordinated Issue Paper. The paper gives guidance on whether gas station convenience store buildings and truck stop structures are property that can be depreciated over 15 years, or whether the property is nonresidential real property that should be depreciated over 31.5 years.

For property that is placed in service in tax years that end after the effective date of this provision, determination of whether the property meets one of the 50% tests generally is made in the year the property is placed in service. If the property is placed in service near the end of the tax year and the use of the property during this period is not representative of the subsequent use of the property, then the test may be applied in the subsequent year. For property placed in service in a tax year before enactment, the determination is based on the IRS paper, but with the test established by the federal Act rather than the paper. If, before enactment, a taxpayer has treated a motor fuel outlet as 15-year property, the taxpayer will be treated as if a valid election was made.

The provision applies to property placed in service on or after August 20, 1996, and to which the Accelerated Cost Recovery System (ACRS) of depreciation, as amended by the federal Tax Reform Act of 1986, applies. Taxpayers may elect to have the amendments apply to any ACRS property placed in service before the effective date. The provision would have an estimated state fiscal effect of a minimal revenue loss.

Income-Forecast Depreciation Method

A number of changes have been made to the way depreciation is computed using the income-forecast method. This method is used to compute depreciation on property that cannot be depreciated under either the Modified Accelerated Cost Recovery System (MACRS) or the intangible amortization provisions of the IRC. The method is used for property such as motion picture films and video tapes, television films, book manuscript rights, patents, master sound recordings, video game machines and other property of a similar character. New rules are provided for determining: (a) the amount of estimated income; (b) the adjusted basis of the depreciated property; (c) the final year's allowable depreciation deduction; and (d) the payment of interest based on the recomputation of depreciation under a look-back method based on actual income verses estimated income.

Determining Income Under The Forecast Method. Under the income-forecast method, depreciation is determined by multiplying the cost of the property (less the estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator is the total estimated income (forecasted income) derived from the property during its useful life. Because the types of revenue that are treated as estimated income from films is expanded, the cost of the films will not be recovered as rapidly as in the past. The income that is taken into account to determine allowable depreciation under the income forecast method is equal to the amount of income earned before the close of the 10th tax year following the year in which the property is placed in service. Consequently, there are 11 tax years taken into account. Generally taxpayers do not have to consider income expected to be generated after the 11th year. Income from films, TV shows and similar property that is taken into account includes income from foreign and domestic sources, theatrical releases, television releases and syndications, and video tape releases, sales, rentals and syndications. When the depreciable property is TV and motion picture films, income must generally include amounts derived from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with films.

Adjusted Basis of Depreciated Property. The adjusted basis of property under the income forecast method of depreciation only includes amounts that satisfy the economic performance standard of the IRC. If a taxpayer incurs a noncontingent liability to acquire property from another person, economic performance will be deemed to occur when the property is provided to the taxpayer. Certain costs are treated as separate property and may result in excluded income for the purposes of applying the income forecast method to the original property. Any costs incurred after the property is placed in service and before the close of the 11-year depreciation period are treated as separate property, if the costs are significant and give rise to a significant increase in the income from the property that was not included in the estimated income from the property. Also, any costs incurred after the close of the 11-year period will be treated as separate property and these costs may be written off and deducted as they are generated.

Final Depreciation Deduction at the End of the 11-Year Period. The depreciation deduction under the income forecast method for the last year of the 11-year depreciation period is equal to the adjusted basis of the property as of the beginning of the tax year.

Interest Computed Under the Look-Back Method. Taxpayers that claim depreciation deductions under the income forecast method pay (or are entitled to receive) interest based on the recalculation of depreciation under a look-back method for any recomputation year. The look-back method does not apply to property that has a basis of $100,000 or less when placed in service. Generally, the recomputation years are the third and tenth tax years after the tax year in which the property was placed in service, unless the actual income from the property for the period before the close of those years was within 10% of the estimated income from the property for that period. The IRS has authority to permit a taxpayer to delay initial application of the look-back method when the taxpayer is expected to have significant income from the property in the third year after the property is placed in service.

The look-back method is applied in any recomputation year by first determining the depreciation deductions using the income forecast method that would have been allowed in the prior tax years if the recomputation had been made using the sum of: (a) the actual income (including income from the disposition of the property) from the property for periods before the close of the recomputation year; and (b) an estimate of future income for periods after the recomputation year and before the close of the 11-year depreciation period. Next the overpayment or underpayment of tax for each prior year that would result solely from the use of recalculated depreciation is determined. Finally, interest is computed on the overpayment or underpayment using a specified rate. A simplified look-back method is used for pass-through entities.

In applying the look-back method, any cost that is incurred after the property is placed in service, if it is not treated as separate property, is discounted to its value as of the date the property was placed in service. Discounting is done by using the federal mid-term interest rate at the time the costs were incurred. The taxpayer may elect not to discount any property.

Interest required to be paid by the taxpayer for any recomputation year is treated as an increase in tax for payment and collection purposes but not for estimated tax payments. Because the new rules apply to property placed in service in tax years that ended before the date of enactment, no estimated tax penalty or penalty for the substantial understatement of income tax will be made for any tax year ending before the date of enactment, to the extent the underpayment was created or increased by the new rules pertaining to the income forecast method of depreciation.

The provisions generally would apply to property placed in service after September 13, 1995. However, they would not apply to any property produced or acquired pursuant to a written contract that was binding on September 13, 1995. The estimated state fiscal effect of these provisions would be a minimal revenue gain.

Leasehold Improvements

A lessor that disposes of or abandons a leasehold improvement, made by the lessor for the lessee, upon termination of the lease may use the adjusted basis of the improvement at the time of disposition or abandonment to determine gain or loss. This basis may be used even if there is no disposition of the underlying building. The provision does not apply to the extent that capitalization of demolition costs and losses apply to the demolition of a structure.

The provision is effective for improvements disposed of or abandoned after June 12, 1996. The provision would result in a minimal state revenue loss.

Depreciation of Water Utility Property

Water utility property is depreciated using a 25-year recovery period and the straight-line method for regular tax purposes. Water utility property is defined as: (a) property that is an integral part of the gathering, treatment, or commercial distribution of water and that would otherwise have had a 20-year recovery period; and (b) any municipal sewer.

The provision is effective for property placed in service after June 12, 1996, other than property placed in service under a binding contract in effect before June 10, 1996 or later. The estimated state fiscal effect would be a minimal revenue gain.

ESOP Loan Interest

The interest income exclusion for loans to employe stock ownership plans (ESOP) is repealed. Consequently, banks, insurance companies, regulated investment companies (such as mutual funds), and corporations actively engaged in the business of lending money may no longer exclude 50% of the interest received on loans to ESOPs or to employer corporations for acquiring employer securities from gross income.

The 50% interest exclusion continues to apply to loans made after August 20, 1996, to refinance loans made on or before August 20, 1996, or to loans made pursuant to a binding contract in effect if the refinancing loan meets requirements in effect before the exclusion was repealed, the outstanding principal of the loan is not increased immediately after the refinancing, and the term of the refinancing loan does not extend beyond the term of the original loan.

The repeal is effective for loans made after August 20, 1996. The provision would increase state revenues by a minimal amount.

Modified Guaranteed Contracts of Life Insurance Companies

Life insurance companies are required to mark-to-market, at the end of each tax year, assets held as part of a segregated account under modified guaranteed contracts. The resulting gain or loss is used in determining a company's net increase or decrease in reserves in arriving at a corresponding income inclusion or deduction. Life insurance reserves include reserves for modified guaranteed contracts that are computed based on rate of interest determined by reference to a market rate of interest. A modified guaranteed contract provides for a guaranteed interest rate for a specified period of time and a market value adjustment in the event that the owner surrenders the contract for cash prior to the end of the guaranteed interest period. A contract is a modified guaranteed contract if it is not a variable contract under provisions of the IRC. In addition, the contract must meet the following requirements: (a) all or part of the amounts received under the contract are required by state law or regulation to be segregated from the company's general asset account and valued at market value; (b) the reserves for the contract must be valued at market value for annual statement purposes; and (c) the contract must provide for a net surrender value or for a policyholder's fund as defined under the IRC.

The provision would be effective for tax years beginning after December 31, 1995. The estimated state fiscal effect would be a minimal revenue gain.

Special Deduction for Certain Health Organizations

Health insurance providers organized under, and governed by, state laws applicable only to not-for-profit health insurance or health service type organizations are allowed to deduct 25% of claims and expenses incurred during the year, less adjusted surplus. These rules under the IRC that benefit Blue Cross and Blue Shield organizations are extended to organizations that are not Blue Cross or Blue Shield organizations but that otherwise meet the requirements. The provision does not apply to health maintenance organizations.

The provision is effective for tax years ending after December 31, 1996. It is estimated that it would result in a minimum state revenue loss.

Contributions of Appreciated Stock

The deduction for contributions of stock to private foundations is extended for contributions made during the period between July 1, 1996 and May 31, 1997. The deduction is equal to the fair market value of qualified appreciated stock. Qualified appreciated stock is publicly traded stock that is capital gain property. The deduction applies only to the extent that total donations of stock in a particular corporation do not exceed 10% of the outstanding stock of the corporation. For purposes of the 10% limit, an individual is treated as making all contributions that are made by any member of the individual's family. The deduction does not apply to contributions made after December 31, 1994, and before July 1, 1996.

The provision is effective for contributions made after June 30, 1996, and before June 1, 1997. The estimated state fiscal effect would be a minimal revenue loss.

Research Credit

The credit for increased research activities is extended for the period between July 1, 1996, through May 31, 1997. The credit expired on June 30, 1995, and it was not retroactively extended so that expenditures paid or incurred from July 1, 1995 through June 30, 1996 are not eligible for the credit. However, a taxpayer that elects the alternative incremental credit regime for its first tax year beginning after June 30, 1996, and before July 1, 1997, may apply the credit to amounts paid or incurred during the first 11 months of that tax year. If the credit is not extended after May 31, 1997, the credit base amount for a tax year affected by the modified credit is reduced to account for the credit's expiration.

The definition of start-up company is expanded to include firms that have both gross receipts and qualified research expenses for the first time in a tax year that begins after 1983. Under prior law, to qualify as a start-up company, a taxpayer had to have fewer than three tax years beginning after December 31, 1983, and before January 1, 1989, in which the taxpayer had both gross receipts and qualified research expenses. A taxpayer can qualify as a start-up company under either definition.

A taxpayer may elect, for its first tax year beginning after June 30, 1996, an alternative method of computing the research credit that uses three tiers of reduced fixed base percentages and credit rates. The election applies to the tax year in which it is made and to all subsequent tax years, unless revoked with the consent of the IRS. Under the alternative computation, a taxpayer's credit is equal to the sum of three tiers of credits:

Tier 1 credit: 1.65% of qualified research expenses for the tax year in excess of a base amount computed using a fixed base percentage of 1%, but not in excess of a base amount computed using a fixed base percentage of 1.5%;

Tier 2 credit: 2.2% of qualified research expenses for the tax year in excess of a base amount computed using a fixed base percentage of 1.5%, but not in excess of a base amount computed using a fixed base percentage of 2%; and

Tier 3 credit: 2.75% of qualified research expenses for the tax year in excess of a base amount computed using a fixed base percentage of 2%.

The alternative computation would allow companies that spend more on research and development now than they did during the 1984-88 base period to claim the credit. The alternative computation may also increase the credit for companies that can claim the research credit using the standard computation.

Taxpayers that conduct research through qualified research consortia are allowed to treat 75% of amounts paid or incurred for qualified research expenses as eligible for the research credit. Prior law rules allowing 65% of contract research expenses paid or incurred for qualified research to be eligible for the research credit continue to apply to amounts not paid to a qualified research consortium. A qualified research consortium is a tax-exempt organization, other than a private foundation, a business league, chamber of commerce or other similar entity, that is organized and operated primarily to conduct scientific research.

Extension of the credit and the new definition of start-up company apply to tax years ending after June 30, 1996. The alternative research credit rules may be elected only for a first tax year beginning after June 30, 1996. The special rule for payments to qualified research consortia applies to tax years beginning after June 30, 1996. The provision would result in an estimated minimal state revenue decrease.

MISCELLANEOUS PROVISIONS

Financial Asset Securitization Investment Trusts

A new entity is created, called a financial asset securitization investment trust (FASIT). A FASIT is used to hold a portfolio of qualified debt obligations, such as credit card receivables, home equity loans and auto loans. However, a FASIT can not engage independently in lending. A FASIT issues asset-backed securities that are treated as debt for federal income tax purposes. FASITs are owned by a single taxable C corporation.

The FASIT offers an advantage to traditional vehicles for securitizing loans, such as revolving trusts. These trusts have certain administrative and financial commitment requirements to ensure that certificates issued by the trust will earn debt status for IRS purposes. In addition, revolving trusts have certain costs associated with earning a rating agency grade, requiring the trust's sponsor to retain a large equity stake in the pool and may necessitate over collateralization.

To qualify as a FASIT, an entity must: (a) make an election to be treated as a FASIT for the current year and all subsequent years; (b) have assets that are substantially permitted assets; (c) issue only nonownership security instruments that meet the requirements for regular interests; (d) have a single ownership interest which is held by a domestic bank or C corporation; and (e) not qualify as a regulated investment company (mutual fund).

The asset test must be met on the 90th day after formation and at all times thereafter. Permitted assets include:

a. Cash and cash equivalents.

b. Debt instruments which are considered debt for federal income tax purposes and bear either a fixed or variable rate of interest tied to a predictable index. Debt may include trade receivables, regular interests in real estate mortgage investment conduits or another FASIT. Debt may not be obligations that were issued by the owner of the FASIT or related person.

c. Certain foreclosure property if the property would be foreclosure property for a real estate investment trust or for such property if not for leases entered into or construction performed while the property is held by a FASIT.

d. Interest rate or foreign currency notional principal contracts, letters of credit, insurance, guarantees against payment defaults or similar instruments which are reasonably required to guarantee or hedge against the FASIT's risk.

e. Securities issued by the FASIT that are treated as debt for federal income tax purposes. Allowable securities include: (1) regular interests yielding no more than five percentage points above the applicable federal rate; and (2) high-yield, high-risk, instruments that may be held only by a domestic C corporation or by a dealer who acquired the security for resale.

f. A regular interest in another FASIT that is an asset-backed security that has fixed terms and meets five requirements: (1) the instrument unconditionally entitles the holder to receive a specified principal amount; (2) the instrument pays either fixed interest or interest that is indexed to a predicable schedule based on rates that measure current variations in the cost of newly borrowed funds; (3) the instrument has a term to maturity of no more than 30 years; (4) the instrument is issued to the public with a premium not exceeding 25% of the stated principal amount; and (5) the instrument has a yield to maturity of no more than five percentage points above the applicable federal rate.

Holders of regular interest in a FASIT must account for the income earned using an accrual method of accounting. Holders of high-yield instruments may not use net operating losses to offset any income derived from high-yield debt; operating loss carryover will be computed by disregarding any income from the disallowed loss.

A dealer may acquire a high-yield debt instrument issued by a FASIT only for the purpose of resale. An excise tax is imposed at the highest corporate rate (35%) if there is a change in dealer status. A safe-harbor rule allows a dealer to hold a high-yield instrument for a 31-day grace period before the instrument is treated as held for investment purposes.

The character of income to the owner is the same as the character to the FASIT, except that tax-exempt interest is treated as ordinary income. All assets are treated as assets and liabilities of the FASIT owner. As such, income, gain, deduction or loss is directly allocable to the owner. Securities held by the FASIT are treated as held for investment by the owner. The owner cannot offset income from ownership interest with any other losses. Any net operating loss carryover of the owner is computed without income from the disallowed loss. The alternative minimum taxable income of an owner cannot be less than the FASIT income for the year.

Gain is recognized immediately by the owner of the FASIT upon the transfer of assets to the FASIT. Assets transferred to the FASIT by someone other than an owner are treated as if they were first acquired by the owner. Any assets of the owner or related person used to support the FASIT's obligations are treated as contributed to the FASIT. The FASIT basis in contributed assets is increased by any taxable gain recognized by the owner.

The value of the assets contributed to the FASIT is computed as the sum of the present values of the cash flows expected from the obligations, discounted over the weighted average life of the contributed loans. The applicable discount rate is 120% of the applicable federal rate compounded semiannually. Each extension of credit is treated as a separate debt instrument for computing the value of the contributed pools of revolving loan accounts. Instrument maturity is determined according to a reasonably anticipated periodic payment rate for principal payments, as a proportion of their aggregate outstanding principal balances, assuming payments are first applied to the earliest credit extension.

Losses on assets contributed to a FASIT are recognized by the owner when the FASIT disposes of the assets.

FASITs are subject to tax at the highest corporate rate on net income from any foreclosure property acquired in connection with the default or imminent default of its loans.

To discourage FASITs from engaging in prohibited activities, an excise tax of 100% is imposed on all net income derived from: (a) nonpermissable assets; (b) disposition of an asset other than a permitted asset; (c) income attributable to loans issued by a FASIT; and (d) compensation for services other than certain fees or waivers, amendments or consents under permitted assets. Permitted dispositions of assets include those resulting from a complete liquidation of a class of regular interests; those incident to foreclosure, default or imminent default of the asset; those incident to bankruptcy or insolvency of the FASIT; those necessary to avoid a default on an indebtedness of the FASIT attributable to a default on a loan held by the FASIT; those facilitating a clean-up call; or those substituting a permitted debt instrument for another instrument to avoid over-collateralization, if the purpose of the disposition is not to avoid recognizing gain from an increase in the assets market value.

This provision is effective September 1, 1997. A transitional rule provides guidance for entities created prior to that date. This provision is estimated to result in a minimal revenue loss.

Insurance Contract on Retired Lives

The term "variable contract" may include contracts that provide for the funding of group term life or group accident and health insurance on retired lives. The contract must provide for the allocation of all or part of the amounts received to a segregated account. Payments in or out must reflect the investment return and the market value of the segregated account. This provision is effective with tax years beginning after December 31, 1995, and is estimated to result in a minimal revenue loss.

Charitable Risk Pools

Qualified charitable risk pools are exempt from tax only if no substantial part of their activities consists of providing commercial-type insurance. Insurance provided at substantially below cost to a class of charitable recipients is not commercial-type insurance. A qualified charitable risk pool is defined as an organization organized and operated solely to pool the insurable risks of its members and to provide information to its members.

To qualify for tax-exempt status, a charitable risk pool must be organized as a nonprofit organization; be exempt from state income tax; obtain at least $1 million in start-up capital from nonmember charitable organizations; be controlled by a board of directors elected by its members; and provide in its organizational documents that members must be tax-exempt charitable organizations. If a member loses its tax-exempt status it must notify the pool immediately.

This provision is effective for tax years beginning after August 20, 1996, and is estimated to result in minimal revenue loss.

State-Sponsored High-Risk Health Insurance Pools

State-sponsored membership organizations that provide high-risk individuals with health coverage are exempt from income tax. In order to be exempt, an organization must be established exclusively for the purpose of providing medical care to high-risk individuals on a not-for-profit basis through either insurance issued by the organization or a health maintenance organization. Only state residents may receive coverage.

This provision is effective for tax years beginning after December 31, 1996, and is estimated to result in a minimal revenue loss.

State-Sponsored Workmen's Compensation Reinsurance Organizations

State-sponsored workmen's compensation reinsurance organizations established by a state before June 1, 1996, exclusively for the purpose of reimbursing their members for losses arising under workmen's compensation acts are exempt from income tax. An organization will qualify if the state requires that the organization's membership consist of persons who issue insurance covering workmen's compensation losses in the state and all persons and governmental entities who self-insure against such losses. The organizations must operate as a nonprofit organization.

This provision is effective with tax years ending after August 21, 1996, and is estimated to result in a minimal revenue loss.

PROVISIONS WITH NO FISCAL IMPACT AND INAPPLICABLE FEDERAL PROVISIONS

In addition to the items listed above, the IRC update would adopt a number of technical modifications and clarifications to federal law that would have no state fiscal effect. Also, a number of provisions of federal law are not applicable to state taxes because the state has its own statutory provisions.

To: Joint Committee on Finance

From: Bob Lang, Director
Legislative Fiscal Bureau

ISSUE

Minor Policy and Technical Changes -- Tax Appeals Commission Filing Fee (General Fund Taxes and Administration -- Attached Programs)

[LFB Summary: Page 34, Item #20; Page 70, Item #9]

GOVERNOR

Increase, from $5 to $25, the filing fee for appeals to the Tax Appeals Commission. In addition, impose a $5 filing fee on appeals related to the Homestead Tax Credit (HTC).

MODIFICATION TO BILL

Increase GPR-Earned by $9,500 annually for Tax Appeals Commission filing fees.

Explanation: Under current law, a taxpayer or municipality can appeal a determination of the state Board of Assessors or the Department of Revenue by filing a petition with the Tax Appeals Commission. Petitioners are required to pay a $5 filing fee, which is deposited in the general fund as GPR-Earned. Appeals related to the Homestead and Farmland Preservation Tax Credits are not subject to the fee. The bill would increase the filing fee from $5 to $25 and specifically impose a $5 filing fee on appeals related to the HTC. However, the bill does not include any additional revenues to reflect the fee increase. As a result GPR-Earned estimates for filing fee collections should be increased by $9,500 annually.

Modification	GPR
1997-99 REVENUE (Change to Bill)	$19,000

Prepared by: Ron Shanovich

MO#________________

JENSEN	Y	N	A
OURADA	Y	N	A
HARSDORF	Y	N	A
ALBERS	Y	N	A
GARD	Y	N	A
KAUFERT	Y	N	A
LINTON	Y	N	A
COGGS	Y	N	A

BURKE	Y	N	A
DECKER	Y	N	A
GEORGE	Y	N	A
JAUCH	Y	N	A
WINEKE	Y	N	A
SHIBILSKI	Y	N	A
COWLES	Y	N	A
PANZER	Y	N	A

AYE_____ NO _____ ABS_____

To: Joint Committee on Finance

From: Bob Lang, Director
Legislative Fiscal Bureau

ISSUE

Tax Amnesty Program (General Fund Taxes)

CURRENT LAW

Under current law, taxes become delinquent when they are not paid by the due date. However, unpaid and unreported taxes are not immediately entered into the delinquent tax collection system but, rather, when an unpaid tax is identified, a bill is sent to the taxpayer. If the bill is not paid within 60 days, the tax is declared delinquent and an account is established for the unpaid tax. Ten days after an account is established, a delinquent tax notice is sent to the taxpayer. The notice indicates that the delinquent tax collection fee has been imposed and that the taxpayer is subject to various kinds of involuntary collection actions if the account is not resolved. If the taxpayer does not respond to the delinquent tax notice, the account is sent to the Central Collection Section or referred to a field agent.

If the case is the first delinquency for the taxpayer, it is assigned to the Central Collection Section. The case is then is referred to an agent who is required to send an informal notice to the taxpayer. The notice attempts to schedule a meeting with the taxpayer to make arrangements to settle the account. If the taxpayer does not respond to the notice or fails to follow through on repayment arrangements made at the informal hearing, the unit may proceed with involuntary collection actions such as withholding delinquent tax amounts from wages or garnishing bank accounts. Also, private collection agencies can be used to collect delinquent taxes. If an account is sizeable and cannot be resolved by the Central Collection Section within six to nine months, it is referred to a field agent.

In cases that involve repeat delinquencies for a taxpayer where the taxpayer does not respond to the delinquent tax notice, a warrant is sent to the taxpayer and the Circuit Court. The warrant places a lien on the delinquent taxpayer's property for the amount of tax, fees, interest and penalty. After the lien is placed, the delinquent account is sent to a field agent who attempts to arrange an informal hearing to resolve the delinquency. If the taxpayer ignores the collection efforts or refuses to pay, the agent may use involuntary collection measures.

Delinquent state taxes are subject to interest of 1.5% a month. Generally, the penalty for failure to file a return is equal to 5% of the tax per month, up to a maximum of 25% of the tax. Other penalties, such as those for fraud, negligence and filing false information, are also imposed and vary depending on the tax and circumstance. A delinquent tax collection fee equal to the greater of $35 or 6.5% of the delinquent balance is also imposed on each new account. The revenue from the fee is used to fund DOR's delinquent tax collection activities.

GOVERNOR

No provision.

DISCUSSION POINTS

Amnesty as Tax Policy

1. Attachment 1 shows the year-end balance of delinquent taxes and the number of delinquent tax accounts, by the type of tax, for fiscal years 1989-90 through 1995-96. (The table does not include accounts under $10 and related accounts. Related accounts are accounts established with more than one taxpayer for the same delinquent tax liability.) The attachment shows that the delinquent account balance has increased 129.2%, from $341.7 million on June 30, 1990, to $783.2 million on June 30, 1996. The individual income and withholding taxes and the sales and use tax have consistently been the primary sources of delinquencies. The number of delinquent accounts increased 29.8%, from 254,370 to 330,192, during that period.

Part of the increase reflects conversion of the funding source for delinquent tax collection activities from GPR to program revenue. The conversion led to actions that affected the delinquent tax balance. First, imposition of the delinquent tax fee in July, 1992, increased the amount owed by each account. The fee was increased again in December, 1995. In addition, under the Department's method of accounting for the delinquent balance, additional interest was added to the balance when the fee was imposed and increased. DOR doesn't formally account for accrued interest on delinquent accounts until a transaction in the account occurs.

2. Since 1995, five states have conducted amnesty programs under which they have granted, for a limited time, complete or partial forgiveness from civil and criminal penalties and interest owed for certain taxpayers on the condition they voluntarily pay the taxes they owe. The states are Connecticut, New York, New Jersey, Pennsylvania and Rhode Island. Attachment 2 provides descriptive information concerning the state amnesty programs for these states. The attachment indicates that the amnesty provisions generally involved the suspension or reduction of civil or criminal penalties. New Jersey provided amnesty from interest owed on delinquent accounts. The level of participation varied with New Jersey experiencing the highest level. Connecticut, New Jersey, New York and Rhode Island had conducted amnesty programs prior

to the most recent ones. Total collections ranged between $359 million in New Jersey to $7.8 million in Rhode Island.

3. Wisconsin conducted an amnesty program from September 15, 1985, through November 22, 1985. The program generated $26.3 million in additional tax collections. The Appendix provides a summary of the provisions of the program.

4. Increases in the delinquent tax balance indicate that the state is losing revenue because many taxpayers, both individuals and corporations, are not filing tax returns or are underpaying amounts owed. It is believed that some of these taxpayers did not file because of financial problems or simply due to oversight. These taxpayers may now be capable of paying taxes, but may be fearful of the possibility of large penalties, and might come forward with amounts owed if they would not have to face penalties.

Tax amnesty is viewed as a mechanism for encouraging such taxpayers to pay back the taxes owed the state. Proponents of tax amnesty believe such programs provide a low-cost, efficient method of collecting delinquent taxes that would otherwise be collected through more expensive methods or remain unpaid. In addition, tax amnesty can encourage nonfilers to come forward and, as a result, broaden the tax base by bringing these individuals back onto the tax rolls. To the extent amnesty would encourage businesses, particularly out-of-state businesses, to file returns, it would address the Department's greatest compliance problem. Finally, tax amnesty programs can provide both a short-term revenue gain and, to the extent nonfilers are identified, can generate increased revenues in future years.

5. However, tax amnesty has been criticized as being inequitable. Under amnesty, taxpayers that pay their taxes voluntarily and on time receive no benefit while others that underpay or do not pay their taxes are not fully penalized for such actions. One could argue that this promotes an injustice by overlooking violations of the law by tax evaders and delinquents. The credibility of the tax system could be undermined, because the legal penalties for noncompliance and delinquency are not enforced under amnesty. This is a potentially serious problem because compliance is primarily voluntary under the current tax system.

Arguably tax amnesty could actually encourage tax evasion and reduce collections in subsequent years if taxpayers anticipate similar programs in the future. This would be of particular concern in Wisconsin if a second amnesty program was enacted so soon after the first program. Moreover, the majority of amnesty collections are often not from delinquent taxpayers. In 1985, $19.2 million of amnesty collections were from assessments of additional liability from audits in progress.

Supporters would counter that the states which recently conducted amnesty programs for a second time (Connecticut, New Jersey, New York and Rhode Island) have indicated that the programs were successful and not detrimental to compliance. The New Jersey program was particularly successful generating the highest per capita revenue ($46.60) of any program ever administered in the U.S. while adding 2,000 new taxpayers to the tax rolls.

Program Design

State officials who have administered tax amnesty programs indicate that careful planning is necessary to ensure that the program will be successful. They point to a number of elements of an amnesty program that need to be considered in designing and implementing such a program. Included in these design factors to consider are eligibility, type of taxes covered, nature of amnesty provided, enhancement of enforcement activities, length of program administration and operational procedures.

Eligibility. On a general level, a basic question related to eligibility is whether or not to include known delinquents in the amnesty program. It is likely that inclusion of known delinquents will increase collections and participation during the amnesty period. Of the states which have conducted amnesty programs, those which have extended eligibility to known delinquents have generally had relatively larger numbers of participants and have generated relatively larger amounts of tax collections. Also, proponents contend that extending amnesty to include known delinquents reduced the costs of seeking out and prosecuting those delinquents below the costs which would be incurred through normal collection procedures.

However, those who oppose including known delinquents in amnesty programs believe that such individuals should be excluded in fairness to honest taxpayers. From this view, amnesty is seen solely a means of increasing the number of current and future taxpayers by attracting nonfilers to the tax rolls. Most of the states which have conducted tax amnesty programs have extended eligibility to known delinquents.

In 1985, both known delinquents and other taxpayers who owed amounts to the Department were eligible for amnesty. To be defined as delinquent the taxpayer's account had to meet one of the following conditions:

1. An assessment existed for which the appeal period had expired prior to the eligibility date and an amount was unpaid during the amnesty period.

2. A nonappealable billing notice which had a due date prior to the eligibility date had been issued and an amount was still unpaid during the amnesty period.

Other taxpayers who were eligible included taxpayers filing late returns voluntarily or upon request; taxpayers filing amended returns; taxpayers who had been assessed or billed; and taxpayers with pending appeals before the Department's Appellate Bureau, the Wisconsin Tax Appeals Commission or a court if they voluntarily withdrew the appeals.

The tax amnesty provisions did not apply in the following types of situations:

1. The persons applying for amnesty were the subject of tax-related criminal investigations or pending criminal prosecutions relating to any tax administered by the department.

2. The amounts for which amnesty was requested were subject to a civil collection action by the Department initiated before the amnesty application was received, or were similarly subject to other types of creditor enforcement proceedings under other state laws. This provision applied to delinquent accounts of nonresidents assigned to a collection agency by the Department.

3. The taxpayer was notified during the amnesty period of an adverse determination of his or her appeal to the Wisconsin Tax Appeals Commission or any court.

4. The person applied for amnesty and was notified of the balance due, yet made no payment or only partial payment of the balance within the period specified by the Department. In such cases, the forgiveness of amounts due or the waiver of penalties, fees and interest was disallowed and the taxpayer owed the full amount of any delinquency or assessment (less the amount of any partial payments made).

5. Amnesty was not allowed to taxpayers appealing an assessment, determination or notice to the Department, Wisconsin Tax Appeals Commission or any court unless the appeal was withdrawn by the taxpayer.

Types of Taxes. Most states which have operated amnesty programs have included all state taxes administered by the Revenue Department or similar agency in the amnesty program. Obviously, if all the state's significant revenue sources are covered, the potential number of participants and amount of revenue generated is greater. If an amnesty program is enacted, all state taxes administered by the Department's Income, Sales and Excise tax division could be included in the program. The 1985 amnesty program applied to the individual income, corporate income and franchise, sales and use, withholding, inheritance and gift, liquor, beer, wine, cigarette, tobacco, motor fuel and special fuel taxes and homestead and farmland tax credits.

Type of Amnesty. The greater the incentives provided to taxpayers the greater will be the participation and revenues that are generated. However, if amnesty provisions are too generous they raise equity issues since they may reward taxpayers who failed to abide by the tax laws or regulations.

From one point of view, an amnesty program should not be designed to create a "competitive premium" for dishonestly by reducing tax costs, including compliance costs, for the tax evader. Therefore, an amnesty should not reduce any ordinary taxpayer responsibilities (filing returns, supplying information), tax due, or normal interest on the liability. Providing any of these forms of relief would create an advantage for the amnesty recipient compared to the normal taxpayer. It is believed that whether or not amnesty discriminates against honest taxpayers depends primarily on the interest rate the government applies to past due taxes. If the rate is below the market rate, the previously dishonest taxpayer in the amnesty gains from what is effectively a low-interest government loan. However, if the interest rate is at or above the market rate, amnesty can provide relief from penalties and prosecution without creating any discrimination favoring the evader. Thus, supporters of this view believe that amnesty should be provided primarily in the form of reduced or suspended civil and criminal penalties and possibly with a reduction in interest.

On the other hand, some would argue that additional incentives should be provided. Total interest forgiveness and possibly some other form of forgiveness would encourage more widespread participation. In turn, this would attract more nonfilers than otherwise be the case, and as a result, add to the state's tax base.

As noted, most states which conducted amnesty programs suspended civil and criminal penalties. Some have offered reduced interest. New Jersey was the only state to forgive all interest owed. The Department of Revenue has recommended that the type of amnesty offered should be easy to compute and consistent.

In the 1985 state amnesty program, the tax amnesty provisions applied in the following types of situations:

1. For taxpayers who had a delinquent tax liability on record as of the starting date of the amnesty period, 20 percent of the delinquent balance as of the date of payment was forgiven. The maximum reduction was $5,000. Amnesty was not allowed unless all tax returns or other documents corresponding with the assessment, determination or notice of the tax lability were properly filed with the Department.

2. For taxpayers with an unpaid tax liability that was not on record as delinquent as of the beginning of amnesty, the Department waived penalties and fees and lowered the interest rate from 1.5% percent (the delinquent rate) to 1% (the normal rate) per month.

3. For taxpayers with a tax liability that was neither reported nor established (unknown), the taxpayers were allowed to file returns and make payment. Penalties, fees, and the right of the Department to seek prosecution were waived provided that proper payment was made. In addition, the interest on delinquent amounts was reduced from 1.5% to 1% per month. However, penalties and the full rate of interest could be imposed if additional taxes were due on the returns filed by the taxpayer, or if the taxpayer defaulted on the amnesty agreement.

In considering the type of amnesty provided, it is important to recognize that the Department's delinquent tax collection activities are entirely funded by the delinquent tax collection fee. The fee is equal to the greater of $35 or 6.5% of the delinquent balance due and is imposed on each new delinquent account at the time it is entered into the delinquent tax system. For 1997-98, base level funding for the Department's delinquent tax collection system

(DTCS) is $9,679,300 with 158.90 authorized positions. If the fee was suspended as part of the amnesty program, an alternative funding source would be needed for the DTCS.

Enhanced Enforcement of Tax Laws. The experience of states which have conducted amnesty programs indicates that an increased compliance effort by the state provides an incentive for delinquent taxpayers to voluntarily participate in the amnesty program, rather than risk the increased chance of detection by taxing authorities following the amnesty. All of the states that operated amnesty programs indicated that they had increased their compliance efforts in conjunction with or subsequent to the amnesty program. As outlined in the Appendix, several additional enforcement provisions were adopted along with the Wisconsin amnesty program in 1985.

Length of the Program. The recent amnesty programs conducted by other states have run from 75 days to three months. Proponents suggest that the length of the program should be long enough to allow taxpayers to complete the research and paperwork necessary to participate but not so long so that the publicity and advertising associated with the program loses its effectiveness. In 1985, the Wisconsin amnesty program ran 68 days, from September 15, 1985, through November 22, 1985.

Administration. Administration of a tax amnesty program involves a number of different activities. Proponents of amnesty point out that one of the key elements in the success of such programs is vigorous promotion and advertising of the program. In addition, returns must be processed, tax forms and supplemental information must be printed and distributed and information must be provided to interested taxpayers. The cost of administering the 1985 amnesty program was $959,700.

Fiscal Effect. The amount of revenue which can be expected to be collected through an amnesty program is dependent on the specific structure of the program, including such elements as eligibility requirements, the level of advertising and promotional activities and the current and expected future compliance activities undertaken by the Department of Revenue. As a result, it is possible to provide only a general estimate of the potential revenues which might be raised through amnesty. If an amnesty program that was similar to the 1985 program was instituted for all taxes administered by the Income, Sales and Excise Division of the Department, an estimated $40 million could potentially be generated. This amount would be offset by administrative costs and funding provided to replace the delinquent tax fee.

Department of Revenue Considerations

When the Committee was considering adopting an amnesty program in 1985, the Department of Revenue developed guidelines which were used to establish and implement the program. To date, DOR has offered some general suggestions for a second amnesty program, but has not prepared specific guidelines. These suggestions, which are outlined below, are not intended to be an indication of the Department's support for tax amnesty.

• Limit debts eligible for amnesty to liabilities that are already delinquent as of some date prior to enactment of the law. This discourages people from not paying current liabilities in anticipation of amnesty.

• For any estimated tax liabilities included in the eligible delinquent balance, require all returns to be filed before amnesty is granted.

• Make the amnesty easy to compute and consistent. The 1985 program allowed forgiveness of 20% of the balance due, up to $5,000.

• Leave the delinquent tax collection fee whole in order to provide adequate revenue to fund collection efforts after the amnesty program ends.

• Limit the required payment window to a period such as 90 days.

• Provide increased enforcement authority after amnesty ends. The Department has not provided specific suggestions for greater enforcement authority.

Because DOR would implement the amnesty program and continue to be responsible for tax administration and collection activities after the program ends, the Committee may wish to obtain additional input from the Department before adopting specific amnesty provisions. Therefore, the Committee could direct the Department to develop a specific proposal for an amnesty program to be considered by the Committee at the September, 1997, s. 13.10 meeting.

ALTERNATIVES TO BILL

1. Maintain current law.

2. Require DOR to develop a proposal for a tax amnesty program to be conducted in the 1997-98 fiscal year. Specify that the Department's proposal must be developed and presented for the Committee's consideration for inclusion in the 1997-99 biennial budget bill.

Alternative 2	GPR
1997-99 REVENUE (Change to Bill)	$40,000,000

3. Require DOR to develop a proposal for a tax amnesty program to be conducted in the 1997-98 fiscal year. Specify that the Department's proposal must be developed and presented for the Committee's consideration at the September, 1997, section 13.10 meeting. Provide that the Department could not implement the amnesty program without approval from the Committee.

Alternative 3	**GPR**
1997-99 REVENUE (Change to Bill)	$40,000,000

Prepared by: Ron Shanovich

MO#____________________

JENSEN	**Y**	**N**	**A**
OURADA	**Y**	**N**	**A**
HARSDORF	**Y**	**N**	**A**
ALBERS	**Y**	**N**	**A**
GARD	**Y**	**N**	**A**
KAUFERT	**Y**	**N**	**A**
LINTON	**Y**	**N**	**A**
COGGS	**Y**	**N**	**A**
BURKE	**Y**	**N**	**A**
DECKER	**Y**	**N**	**A**
GEORGE	**Y**	**N**	**A**
JAUCH	**Y**	**N**	**A**
WINEKE	**Y**	**N**	**A**
SHIBILSKI	**Y**	**N**	**A**
COWLES	**Y**	**N**	**A**
PANZER	**Y**	**N**	**A**

AYE_____ NO _____ ABS_____

ATTACHMENT 1

Year-End Delinquent Tax Balance and Number of Accounts, by Type of Tax
Fiscal Years 1989-90 through 1995-96*

	1989-90	1990-91	1991-92	1992-93***	1993-94	1994-95****	1995-96****
Individual Income							
Amount	$119,309,000	$127,655,000	$132,017,000	$212,978,000	$206,812,000	$234,285,091	$228,185,600
Count	74,384	69,957	67,869	72,127	66,008	72,767	67,496
Individual Withholding							
Amount	76,612,000	115,106,000	138,836,000	196,479,000	207,179,000	222,370,336	246,609,430
Count	57,477	71,785	74,369	82,792	88,187	91,877	95,638
Corporate Income							
Amount	17,795,000	19,190,000	22,282,000	39,525,000	44,084,000	50,068,332	54,012,909
Count	14,607	15,328	14,666	13,676	16,298	17,545	17,248
Sales							
Amount	115,377,000	130,534,000	147,326,000	163,811,000	179,804,000	193,159,759	199,951,979
Count	106,681	115,753	120,516	129,739	135,566	139,026	137,933
Other**							
Amount	12,563,000	14,807,000	25,841,000	39,943,000	51,695,000	52,983,035	54,442,254
Count	1,221	1,320	1,494	2,454	5,690	8,392	11,877
TOTAL							
Amount	$341,656,000	$407,292,000	$466,302,000	$652,736,000	$689,574,000	$752,866,553	$783,202,172
Count	254,370	274,143	278,914	300,788	311,749	329,607	330,192

SOURCE: Department of Revenue

* Totals do not include related accounts and accounts under $10.

** Includes aviation fuel, special fuel, inheritance, liquor, motor fuel, tobacco, utility and gift taxes and real estate transfer fees. Drug tax delinquencies were added in 1990-91; recycling surcharge delinquencies were added in 1991-92; manufacturing penalty in 1995; exposition center tax in 1996; stadium tax in 1997.

*** Includes $32 million in delinquent tax fee assessments and $173 in accrued interest, first reported as a result of imposition of the fee. The delinquent tax fee was authorized under 1991 Wisconsin Act 39 (the 1991-93 biennial budget act).

**** Includes increased delinquent tax fee assessments due to increase in delinquent tax fee, as provided in 1995 Wisconsin Act 27. The fee increase caused the posting of approximately $116 million in interest.

ATTACHMENT 2

Characteristics of Tax Amnesty Programs in Other States

State	Length of Programs	Eligible Taxpayers	Types of Taxes Included	Nature of Amnesty	Revenue Collected	Number of Participants	Administrative Costs
Connecticut	Three Months 1995	Nonfilers and known delinquents	All taxes	Civil and criminal penalties, reduced interest	$46.2 million	14,900	$1.0 million
New Jersey	90 days 1996	Nonfilers and known delinquents	All taxes	Civil and criminal penalties, all interest, 5% penalty on taxes unpaid at end of amnesty period	$359 million	114,000	$10 million
New York	Three months Nov, 1996 to January, 1997	Nonfilers and known delinquents	Personal income, corporate franchise, sales and use, estate and gift, motor fuel and certain other state and local taxes	Civil and criminal penalties	$275 million through May 13, 1997	N.A.	N.A.
Pennsylvania	Three months 1995 to 1996	Nonfilers and known delinquents	All taxes	Civil and criminal penalties	$91 million	56,000	$9.6 million
Rhode Island	75 days 1996	Nonfilers and known delinquents	All taxes	Civil and criminal penalties	$7.8 million	2,213	$300,000

APPENDIX

1985 Wisconsin Tax Amnesty Program

The tax amnesty program was established by 1985 Wisconsin Act 29 (the 1985-87 biennial budget act). The program was not included in the Governor's budget recommendations but was incorporated into the budget bill (1985 Assembly Bill 85) by the Joint Committee on Finance and modified by the Legislature. The following sections describe each of the specific components of the program.

Eligibility. The amnesty program applied to delinquent taxpayers (as specifically defined for the program); nonfilers who owed taxes, interest or penalties; taxpayers who filed late returns voluntarily or upon request; taxpayers who filed amended returns; taxpayers that were assessed or billed; and taxpayers with pending appeals before the Department of Revenue's (DOR) Appellate Bureau, the Wisconsin Tax Appeals Commission or a court that could withdraw the appeals. The program excluded certain taxpayers from eligibility for amnesty, such as accounts involving criminal investigations or criminal complaints.

Taxes. All state taxes that were administered by the Income, Sales, Inheritance and Excise Tax Division in DOR were included in the program. Specifically, the program applied to: the individual and corporate income and franchise taxes; sales and use taxes; withholding tax; inheritance and gift taxes; liquor, beer, wine, cigarette and tobacco taxes; motor fuel and special fuel taxes; and homestead and farmland tax credits.

Amnesty. Under the amnesty provisions, the Department of Revenue was authorized to: (a) waive civil and criminal penalties; (b) waive late filing fees; (c) reduce from 18% to 12% the rate of interest owed by nondelinquents; and (d) reduce tax liability by 20%, up to a maximum amount of $5,000. The addition to tax penalty for civil fraud that was assessed prior to the date of applying for amnesty was not waived.

Enhanced Enforcement. In conjunction with the amnesty program, a number of compliance provisions were enacted and strengthened. Included among these enhanced enforcement provisions were the following:

(a) A levy law was established to allow for direct seizure of the assets of a delinquent taxpayer;

(b) The penalty for tax fraud was increased from 50% to 100% of the amount of the tax on the underpayment;

(c) Late filing fees under the individual and corporate income and franchise taxes were increased from $10 to $20 for returns filed more than 60 days late.

In addition, there were a number of enhanced compliance provisions that were included in Act 29 that were in the Governor's recommendations and, thus, not directly linked to the amnesty program but worked to increase the incentive for delinquent taxpayers to participate. For example, as submitted by the Governor, AB 85 contained provisions that authorized state agencies to revoke or refuse to renew or issue occupational licenses for persons who owed delinquent state taxes.

Length of Program. The program ran from September 15, 1985, through November 22, 1985. Taxpayers could apply for amnesty only during this time period.

Miscellaneous Operational Provisions. The cut-off date after which taxpayers who became delinquent or failed to file were no longer eligible to apply for amnesty was May 15, 1985. Taxpayers were required to submit a written application in order to participate in the program. All amounts that were due had to be paid in full and all returns had to be filed, including returns for which an estimated assessment was issued. Payments were made in cash, money order, cashier's check or other guaranteed amounts and had to be paid within 90 days after receiving notification from the Department. All amounts paid under amnesty were final and conclusive. No refunds were allowed at a later date, regardless of other statutory changes.

Administration. The Department of Revenue was provided $959,700 to administer the amnesty program.

Revenue. In Act 29, the revenue generated by the amnesty program was placed in a separate segregated fund and used to cover the costs of operating and administering the elderly property tax deferral program. However, as part of a number of measures that were included in 1985 Wisconsin Act 120 (the 1986 Fiscal Management Bill) to address a projected $340 million revenue shortfall in 1986-87, amnesty collections were transferred to the general fund. Originally, it was estimated that the amnesty program would generate $10 million; actual collections were approximately $26.3 million.