I

Revenue

Tax Administration

Bill Agency

(LFB Budget Summary Document: Page 587)

LFB Summary Item for Which an Issue Paper Has Been Prepared

Item #	Title
-	Administration of County Sales Tax, Special District Taxes and Local Professional Football Stadium District Taxes (Paper #803)

AGENCY: DOR - Tax Administration

PAPER: #803

ISSUE: County Sales Taxes

RECOMMENDATION: Part A - Alternative
Part B - Alternative
Part C - Alternative 1
Part D - Alternative

SUMMARY: Sen. Hansen supports alt 1 on Part C. I'm waiting for comments from Milwaukee County on the others.

BY: Barry

Legislative Fiscal Bureau

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June 5, 2001 Joint Committee on Finance Paper #803

Administration of County Sales Tax, Special District Taxes and Local Professional Football Stadium District Taxes (DOR -- Tax Administration)

CURRENT LAW

Wisconsin counties can impose a 0.5% sales tax on the same goods and services that are subject to the state sales tax. The county sales tax is "piggybacked" onto the state sales tax in that the county tax is administered, enforced and collected by the Department of Revenue (DOR). DOR retains 1.75% of county sales taxes it collects in a program revenue appropriation to cover administrative costs. The year-end unencumbered balance in the appropriation is lapsed to the general fund. Currently, 54 counties impose the tax.

A 0.1% sales and use tax is imposed on the same goods and services that are subject to the state sales tax in Milwaukee, Ozaukee, Racine, Washington and Waukesha counties to fund a local professional baseball district (District). The District was created to fund the construction and operation of a new baseball stadium for the Milwaukee Brewers (Miller Park). DOR administers the sales and use taxes on behalf of the District and retains 1.5% of collections to fund administrative costs.

A 0.5% sales and use tax is imposed on the same goods and services that are subject to the state sales tax in Brown County to provide funding for the Green Bay--Brown County Professional Football Stadium District. The District was created to fund the construction and maintenance of a renovated football stadium for the Green Bay Packers (Lambeau Field). DOR administers the sales and use tax for the District and retains 1.5% of collections for administrative costs.

GOVERNOR

No provision.

DISCUSSION POINTS

County Sales Tax

1. DOR is provided $3,053,600 PR in base level funding and 33.25 PR positions to administer the county sales tax. The county tax is administered as part of the state sales tax administration system. Costs and positions are assigned to the county sales tax administration appropriation based on the workload attributed to administering the county tax.

2. Prior to 1992, DOR retained 3% of county sales taxes to fund the costs of administering the tax. Because the revenue retained by the state exceeded the state's administrative costs, the amount of collections retained was reduced from 3% to 1.5% in 1991 Wisconsin Act 37. The 1991-93 budget adjustment bill (1991 Wisconsin Act 269) transferred $1.4 million that had accumulated in the administrative appropriation to the general fund. Under the provisions of the 1995-97 biennial budget (1995 Wisconsin Act 27), an additional $1.2 million was transferred to the general fund on June 30, 1997. The bill would have decreased the amount of sales tax retained by DOR from 1.5% to 1.3%, but the provision was vetoed. The 1997-99 biennial budget included a provision that requires the unencumbered fiscal year-end balance in the county sales tax administrative appropriation to be lapsed to the general fund. The bill also contained a provision that would have reduced the amount of sales taxes retained by the Department from 1.5% to 1.3%. However, the provision was vetoed.

3. The 1999-01 biennial budget (1999 Wisconsin Act 9) increased from 1.5% to the current 1.75%, the amount of county sales tax revenue retained by DOR to fund administrative costs. Expenditure authority was also substantially increased (by $750,000 PR in 1999-00 and $800,000 PR in 2000-01) to fund costs associated with incorporating administration of the county sales tax into the Department's integrated tax system (ITS). At that time, it was estimated that revenues generated from the 1.5% state share of collections would be sufficient to fund the increased expenditures and other county sales tax administrative expenses. However, it was argued that the increase in the share of revenues retained by the state to 1.75% of collections provides reimbursement for general administrative services, such as data processing, that are provided because the county sales tax is collected as part of the state's general sales tax processing system. Because these general administrative services are funded with GPR, it is justifiable to transfer some county sales tax revenues to the general fund.

4. Table 1 shows the estimated revenues, expenditures (including compensation reserves and other adjustments) and lapses for the county sales tax administration appropriation under the provisions of the bill. The table shows that the amounts lapsed to the general fund would be $782,800 in 2001-02 and $948,400 in 2002-03. Since the administration estimated a lapse of $827,700 in 2001-02 and $1,072,800 in 2002-03, these amounts represent a decrease of $169,300 in the biennium compared to the administration's estimates.

TABLE 1

Estimated County Sales Tax Administration Appropriation Revenues, Expenditures and Lapses Under Provisions of the Bill

	2001-02	2002-03
Revenues	$3,997,600	$4,233,100
Expenditures	- 3,214,800	- 3,284,700
Lapse	$782,800	$948,400

5. Since 1992, the state's share of county sales tax collections has generated revenues in excess of the amounts needed to fund expenditures. Table 1 shows that the current 1.75% state share would result in substantial lapses to the general fund in both 2001-02 and 2002-03. Essentially, this is a transfer of sales taxes from the counties to the state general fund.

6. Since the counties impose the sales tax, it has been argued that the counties should retain revenues that are not necessary to fund the state's administrative expenses. These monies should be used to fund county services. As an alternative, the share of county sales tax revenues retained for DOR administrative expenses could be reduced from 1.75% to 1.5%. This would correspond to the percentage of revenues retained by the state to administer the baseball park and football stadium district sales taxes. Assuming the change took effect August 1, 2001, counties would receive an additional $520,300 in 2001-02 and $603,900 in 2002-03. However, there would be a corresponding decrease in GPR-earned for the state.

7. Table 2 shows the estimated revenues, expenditures and lapses for the county sales tax administrative appropriation with the state retaining 1.5% of collections for administrative costs. The table shows that estimated revenues would be sufficient to cover administrative costs and there would continue to be lapses to the general fund for general administrative overhead. If the amount of lapses continued to increase, the percentage of collections retained for administrative costs could be further reduced in the 2003-05 biennial budget.

TABLE 2

Estimated County Sales Tax Administration Appropriation Revenues, Expenditures and Lapses With a 1.5% State Share of Collections

	2001-02	2002-03
Revenues	$3,477,300	$3,629,200
Expenditures	- 3,214,800	- 3,284,700
Lapse	$262,500	$344,500

8. The Legislative Audit Bureau recently released an audit that reviewed administration of the county sales tax by DOR. The audit indicated that the 90- to 180- day time limit for distributing county sales and use tax revenues authorized in the statutes is longer than limits established by other states. The audit recommended that the Legislature shorten the time limit to require DOR to distribute the tax to county governments within 75 days of the retailer deadline. In addition, in reviewing the Department's staff time reporting system, the Audit Bureau found that administrative fees supported more full-time equivalent positions than were reportedly used to administer the county sales and use tax. The audit also found that the amount of integrated tax system costs funded by the county sales and use tax administrative fee appears to have been based on the unencumbered funds available in the county sales tax appropriation for administration of the tax, rather than on an analysis of system costs and benefits. In response to the audit, the Committee may wish to adopt the recommendation to reduce the distribution time limit to 75 days. The Committee could also delete 1.0 PR revenue agent and 1.0 PR senior programmer analyst and expenditure authority of $115,100 PR in 2001-02 and $116,300 PR in 2002-03 to reflect audit findings that less than the current level of staffing is necessary to administer the county sales tax. The annual lapse from the county sales tax administration appropriation would increase by the amount of reduced expenditure authority.

Special District Taxes (Baseball Stadium District)

9. Base level funding of $380,300 PR and 5.5 PR positions are provided to administer special district taxes (local professional baseball park district tax). The tax is administered as part of the state general sales tax administrative system and the expenses for baseball park district activities and positions are charged to the special district taxes administration appropriation.

10. The 0.1% District sales tax was first imposed in January, 1996. District sales tax revenues are used to: (a) pay debt service (principal and interest) on District bonds used to finance construction of the Brewers baseball stadium; (b) pay for lease certificates of participation used to lease and fund certain stadium equipment; and (c) contribute towards the maintenance and repair of the stadium. If the District's tax revenues exceed current operating expenses, the excess amount will be placed in a fund for future maintenance and capital improvement costs or to retire the bonds early. Once sufficient funds are available to meet the obligations of the District, the 0.1% sales tax will end. In a review of the District's costs released by the Legislative Audit Bureau in June, 1999, it was estimated that it would be necessary to collect the tax through at least 2014.

11. Since it was first imposed, DOR has been authorized to retain 1.5% of total collections to fund the costs of administering the local baseball park district tax. Table 3 shows estimated revenues and expenditures (including compensation reserves and other adjustments) and the year-end balance of the administrative appropriation for the biennium. The table shows that the appropriation is projected to have a deficit in each fiscal year of the biennium. Moreover, DOR has developed estimates that indicate that, because annual expenditures will exceed annual revenues, the deficit in the appropriation will continue to increase until 2005, when it would first begin to decrease.

TABLE 3

Estimated Special District Taxes Administration Appropriation Revenues, Expenditures and Appropriation Balances

	2001-02	2002-03
Opening Balance	- $132,800	- $199,400
Revenues	350,400	375,400
Expenditures	- 417,000	- 428,600
Closing Balance	- $199,400	- $252,600

12. One alternative to address the deficit would be to provide a one-time transfer of $260,000 in 2001-02 from the county sales tax administration appropriation to the local baseball park administrative appropriation. This would eliminate the deficit in the appropriation during the biennium and allow DOR to develop and implement a plan for addressing the deficit in future years. It could be argued that this would be an appropriate use of the funds because both the county sales tax and local baseball park administrative systems are included as part of the state's general sales tax administrative system and benefit from general administrative services provided by the system. Because of the lapse of excess revenues from the county sales tax administration appropriation to the general fund, the transfer is essentially a GPR supplement to the District tax administration appropriation, which would reduce GPR-earned by $260,000 in 2001-02.

13. Because ongoing expenditures exceed ongoing revenues, as a second alternative, a senior programmer analyst position and expenditure authority of $68,100 in 2001-02 and $68,800 in 2002-03 could be deleted from the special district taxes appropriation. The programmer position is responsible for computer system support. A project leader specialist also provides computer support and the program would also have 3.5 other positions for administration. Also, computer support could be provided by other programmers assigned to the sales tax administration system. At the current staff level, the ratio of administrative positions to revenues collected is higher for special district tax administration than for the state and county sales tax administrative staffs. This action would cause ongoing revenues to exceed expenditures and the appropriation deficit would begin to decline during the biennium. DOR could request that the position and expenditure authority be restored under s. 16.515 when the deficit was eliminated. However, this would require the Department to reallocate the incumbent to another position. Sales tax administration staff would be required to perform the deleted position's activities along with existing responsibilities. It should also be noted that, under base budget reductions, the bill would require DOR to reduce overall GPR expenditures by $4,216,300 annually. As a result, the Department staff would have to absorb the effects of this GPR funding reduction in addition to the reduction in special district tax administrative staff.

Professional Football Stadium District Taxes

14. A local professional football stadium district for the construction and maintenance of a renovated football stadium for the Green Bay Packers was created by 1999 Act 167. The Green Bay-Brown County Professional Football Stadium District is contiguous with Brown County and governed by a seven-member board. The District is provided authority, if approved by the electors of the District at referendum, to impose a 0.5% sales and use tax for purposes related to football stadium facilities. On September 12, 2000, the voters of Brown County approved the District resolution imposing the sales and use tax. The tax was effective November 1, 2000.

15. The District is limited in the types and amount of stadium-related costs that can be funded from District sales and use tax revenues. Revenues can first be used to pay the annual debt service on outstanding District revenue obligations (bonds). The next allowable use for the revenues is to pay the annual principal and interest cost on any county loan from the Board of Commissioners of Public Lands for the acquisition, renovation or construction of football stadium facilities. Any excess revenues must be used, in order, for the following purposes: (a) to fund certain specified direct administrative costs; (b) to pay certain specified operating and maintenance expenses; and (c) to fund early retirement of certain bonds and fund a maintenance and operating cost fund.

16. Act 167 authorized DOR to retain 1.5% of District sales and use tax collections for administering the professional football stadium district tax and created an appropriation for the administrative finding. However, no positions or expenditure authority were provided in the Act.

17. In October, 2000, the Joint Committee on Finance, acting under s. 16.515 of the statutes, provided DOR with permanent positions and funding to administer the football stadium district tax. Specifically, the Committee provided DOR with expenditure authority of $388,600 PR in 2000-01, $207,500 PR in 2001-02 and $137,600 PR in 2002-03 and 1.50 PR permanent positions and 1.0 project position ending June 30, 2002 to implement and administer the tax. However, the bill does not include this funding and position authority. A technical modification is necessary to provide the Department with the funding and positions approved under s.16.515.

18. Table 4 shows estimated revenues, expenditures (including compensation reserves and other adjustments) and the appropriation balances in the professional football stadium district tax administration appropriation. The table shows that the appropriation is projected to have a deficit in each year of the biennium. However, this is because start-up costs will be incurred before a full year of tax revenues are collected. On an annual basis, revenues exceed expenditures and the deficit should be eliminated during the 2003-05 biennium.

TABLE 4

Estimated Professional Football Stadium Administration Revenues, Expenditures and Appropriation Balances

	2001-02	2002-03
Opening Balance	- $242,500	- $196,200
Revenues	259,300	274,600
Expenditures	- 213,000	- 145,400
Closing Balance	- $196,200	- $67,000

Consolidated Appropriation

19. As noted, county sales taxes, special district taxes and professional football stadium district taxes are administered as parts of the state sales tax administration system. DOR covers the administrative costs of administering each tax by retaining a portion of tax collections. It has been argued that, as parts of the same system, each of these tax collection programs share certain general administrative services, such as taxpayer assistance, general data processing and compliance activities. From this view, an alternative that would improve administrative efficiency would be to consolidate the local tax collection funding and positions into a single appropriation. The Department could retain 1.5% of total collections to fund administrative costs and the unencumbered balance in the appropriation in excess of 10% of fiscal year expenditures could be lapsed to the general fund. However, there would be no lapses to the general fund during the 2001-03 biennium. The appropriation would begin lapsing amounts to the general fund in the 2003-05 biennium. Compared to the bill, the consolidation would decrease GPR-earned by an estimated $827,700 in 2001-02 and $1,072,800 in 2002-03. Alternatively, the year-end unencumbered balance in the appropriation could be returned to counties and the professional football and baseball stadium districts based on each entity's proportionate share of total taxes collected. This would eliminate the transfer of GPR-earned to the general fund. Table 5 shows estimated revenues, expenditures and lapses for a single administrative appropriation.

TABLE 5

Estimated Revenues, Expenditures and Lapses for a Combined Administrative Appropriation

	2001-02	2002-03
Opening Balance	- $369,600	- $133,100
Program Revenues	4,081,300	4,273,500
Expenditures	- 3,844,800	- 3,858,700
Closing Balance	- $133,100	$281,700
10% Reserve	$0	$281,700
Lapse	$0	$0

20. From another view it could be argued that it would not be appropriate to have a single appropriation for administering each of the three local tax administration programs because each program covers a different jurisdiction, different purposes for imposing the taxes and different taxing authorities. Moreover, at least initially, county sales tax administrative funding would fund costs for administering the professional baseball and football stadium district taxes.

21. A total of 41.25 positions would be funded through the consolidated tax administration appropriation. Of the total, seven positions would provide computer system support and six would be involved in taxpayer registration. As an alternative, one programmer analyst under special district taxes and one revenue agent position could be deleted to recognize administrative efficiencies that would occur by combining staffing and funding for the local tax administration programs. Specifically, 2.0 positions and expenditure authority of $127,200 in 2001-02 and $128,500 in 2002-03 could be deleted. As a result, there would be a lapse to the general fund of $164,400 In 2002-03. If DOR determined that the remaining positions and funding were insufficient to meet administrative responsibilities, DOR could request that the positions and expenditure authority be restored under s. 16.515. Table 6 shows estimated revenues expenditures and lapses from a consolidated appropriation with the proposed reduced funding and position authority.

TABLE 6

Estimated Revenues, Expenditure sand Lapses for a Combined Administrative Appropriation

	2001-02	2002-03
Opening Balance	-$369,600	-$5,900
Program Revenues	4,081,300	4,273,500
Expenditures	-3,717,600	-3,730,200
Closing Balance	-$5,900	$537,400
10% Reserve	$0	$373,000
Lapse	$0	$164,400

22. DOR would note that consolidating the appropriations would not reduce the Department's administrative responsibilities regarding the local sales taxes. From this view, the current level of administrative support provided is based on the Department's experience in administering a large number of tax administration programs and that level of support is necessary to meet administrative responsibilities. In addition, DOR would have to reallocate incumbents in the deleted positions to existing vacant positions and sales tax administrative staff would have to absorb the administrative responsibilities of the deleted positions. Moreover, as noted, the bill would require DOR to reduce overall GPR expenditures by $4,216,300 each year and Department staff would have to absorb the effects of this reduction as well.

ALTERNATIVES TO BILL

A. County Sales Tax

1. Reduce from 1.75% to 1.5%, the percentage of tax revenues DOR retains to administer the county sales tax. Reestimate the lapse from the county sales tax appropriation to the general fund to be $262,500 in 2001-02 and $344,500 in 2002-03.

Alternative A1	GPR
2001-03 REVENUE (Change to Bill)	- $1,284,500

2. Maintain current law. Reestimate the lapse from the county sales tax administration appropriation to be $782,800 in 2001-02 and $948,800 in 2002-03.

Alternative A2	GPR
2001-03 REVENUE (Change to Bill)	- $169,300

3. Require the Department of Revenue to distribute county sales tax collections to the counties within 75 days of the retailer deadline.

4. Delete 1.0 revenue agent and 1.0 senior programmer analyst position and $115,100 PR in 2001-02 and $116,300 PR in 2002-03 from the county sales tax administration appropriations.

Alternative A4	GPR	PR	TOTAL
2001-03 REVENUE (Change to Bill)	$231,400	$0	$231,400
2001-03 FUNDING (Change to Bill)	$0	- $231,400	- $231,400
2002-03 POSITIONS (Change to Bill)	0.00	- 2.00	- 2.00

B. Administration of Special District Taxes

1. Transfer $260,000 in 2001-02 from the unencumbered balance in the county sales tax administration appropriation [20.566(1)(g)] to the special district taxes administration appropriation [20.566(1)(gd)].

Alternative B1	GPR
2001-03 REVENUE (Change to Bill)	- $260,000

2. Delete 1.0 programmer analyst and expenditure authority of $68,100 in 2001-02 and $68,800 in 2002-03 from the special district tax administration appropriation [20.566(1)(gd)].

3. Maintain current law.

Alternative B3	PR
2001-03 FUNDING (Change to Bill)	- $136,900
2002-03 POSITIONS (Change to Bill)	- 1.00

C. Administration of Professional Football Stadium District Taxes

1. Provide $207,500 PR in 2001-02 and $137,600 PR in 2002-03 and 1.50 PR permanent positions and 1.0 PR project position ending June 30, 2002, to the professional football district administrative appropriation [20.566(1)(ge)] to implement and administer the tax. (The funding and the positions were approved in October, 2000, under s. 16.515 of the statutes but are not included in the bill.)

Alternative C1	PR
2001-03 REVENUE (Change to Bill)	$345,100
2002-03 POSITIONS (Change to Bill)	2.50

2. Maintain current law.

D. Consolidated Appropriation

1. Consolidate the funding and positions supported by the county sales tax administration [20.566(1)(g)], administration of special district taxes [20.566(1)(gd)] and administration of a professional football stadium district [20.566(1)(ge)] appropriations into a single appropriation. Provide that the year-end unencumbered balance in the appropriation in excess of 10% of expenditures lapse to the general fund.

Alternative D1	GPR
2001-03 REVENUE (Change to Bill)	- $1,900,500

2. Consolidate the funding and positions supported by the county sales tax administration [20.566(1)(g)], administration of special district taxes [20.566(1)(gd)], and administration of a professional football stadium district [20.566(1)(ge)] appropriations into a single appropriation. Provide that the year-end unencumbered balance in the consolidated appropriation in excess of 10% of expenditures be returned to the taxing jurisdictions based on their proportionate contribution to total revenues.

Alternative D2	GPR
2001-03 REVENUE (Change to Bill)	- $1,900,500

3. Consolidate the funding and positions supported by the county sales tax administration [20.566(1)(g)], administration of special district taxes [20.566(1)(gd)], and administration of a professional football stadium district [20.566(1)(ge)] appropriations into a single appropriation. In addition, delete 1.0 PR programmer analyst and 1.0 PR tax revenue agent and expenditure authority of $127,200 PR in 2001-02 and $128,500 PR in 2002-03 from the consolidated appropriation. Provide that the year-end unencumbered balance in the appropriation in excess of 10% of expenditures lapse to the general fund. Estimate the lapse to the general fund from the consolidated appropriation to be $164,400 in 2002-03.

Alternative D3	GPR	PR	TOTAL
2001-03 REVENUE (Change to Bill)	- $1,736,100	$0	- $1,736,100
2001-03 FUNDING (Change to Bill)	$0	- $255,700	- $255,700
2002-03 POSITIONS (Change to Base)	0.00	- 2.00	- 2.00

4. Consolidate the funding and positions supported by the county sales tax administration [20.566(1)(g)], administration of special district taxes [20.566(1)(gd)] and administration of a professional football stadium district [20.566(1)(ge)] appropriations into a single appropriation. In addition, delete 1.0 PR programmer analyst and 1.0 PR tax revenue agent and expenditure authority of $127,200 PR in 2001-02 and $128,500 PR in 2002-03 from the consolidated appropriation. Provide that the year-end unencumbered balance in the appropriation in excess of 10% of expenditures be returned to the taxing jurisdictions based on their proportionate contribution to total revenues.

Alternative D4	GPR	PR
2001-03 REVENUE (Change to Bill)	- $1,900,500	$0
2001-03 FUNDING (Change to Bill)	$0	- $255,700
2002-03 POSITIONS (Change to Bill)	0.00	- 2.00

MO# A-2+3, B-2, C-1

2 BURKE	(Y)	N	A
DECKER	(Y)	N	A
MOORE	(Y)	N	A
SHIBILSKI	(Y)	N	A
PLACHE	(Y)	N	A
WIRCH	(Y)	N	A
DARLING	(Y)	N	A
WELCH	(Y)	N	A
1 GARD	(Y)	N	A
KAUFERT	(Y)	N	A
ALBERS	(Y)	N	A
DUFF	(Y)	N	A
WARD	(Y)	N	A
HUEBSCH	(Y)	N	A
HUBER	(Y)	N	A
COGGS	(Y)	N	A

AYE 16 NO 0 ABS ____

Senator Welch

SHARED REVENUE AND TAX RELIEF -- DIRECT AID PAYMENTS

Depreciation Schedule for Exempt Computers

[Paper #831]

Motion:

Move to establish a depreciation schedule for valuing exempt computer property under which computer property would be valued at 67% of its original cost in the year following its acquisition and at 33% of its original cost in the year two years following its acquisition. Specify that the value of exempt computers that are three or more years old be set at zero. Extend these provisions to the valuation of exempt computers as currently determined by owners of personal property on returns filed with assessors, by municipalities with regard to the May 1 report they are required to file annually with DOR, and by DOR with regard to its valuation of manufacturing property and its certification of exempt computer values for purposes of state aid calculations. Provide that these provisions first apply to values determined as of January 1, 2002. Decrease funding for computer aid payments by $37,300,000 GPR in 2002-03 to a reflect reestimate of the sum sufficient aid payment at $41,100,000 GPR in 2002-03.

Note:

The motion would change the depreciation schedule that is used to value exempt computers by shortening the schedule from eight years to two years. The current schedule is based on a four-year useful life since most of the value is depreciated after four years. The following table compares the schedule certified by DOR for 2001 values to the proposed schedule:

Years Since Acquisition	Percent of Original Cost: Current	Percent of Original Cost: Proposed
1	81.3%	67.0%
2	50.8	33.0
3	31.8	0.0
4	19.9	0.0
5	12.4	0.0
6	7.8	0.0
7	4.8	0.0
8 or earlier	3.0	0.0

The motion would have the effect of reducing the amount of exempt computer value on which state aid is paid. For 2002, the value is estimated to decrease from $3.2 billion to $1.7 billion.

[Change to LFB Paper #831: -$37,300,000 GPR]

MO#________________

BURKE	Y	(N)	A
DECKER	Y	(N)	A
MOORE	Y	(N)	A
SHIBILSKI	Y	(N)	A
PLACHE	Y	(N)	A
WIRCH	Y	(N)	A
DARLING	(Y)	N	A
WELCH	(Y)	N	A
GARD	(Y)	N	A
KAUFERT	(Y)	N	A
ALBERS	(Y)	N	A
DUFF	(Y)	N	A
WARD	(Y)	N	A
HUEBSCH	(Y)	N	A
HUBER	Y	(N)	A
COGGS	Y	(N)	A

AYE 8 NO 8 ABS ____

General Fund Taxes

Individual and Corporate Income Taxes

Bill Agency

(LFB Budget Summary Document: Page 20)

LFB Summary Items for Which Issue Papers Have Been Prepared

Item #	Title
2	Indexing Top Bracket (Paper #100)
3	Earned Income Tax Credit: Current Law Reestimates (Paper #101)
6	Illinois-Wisconsin Income Tax Reciprocity Payments (Paper #102)
9	Corporate Income and Franchise Tax -- Single Sales Factor Apportionment Formula (Paper #103)
10	Tax Treatment of Corporate Partners and LLC Members (Paper #104)
12	Milwaukee Development Opportunity Zone and Capital Investment Credit (Paper #105)
13	Technology Zones (Paper #106)
-	IRC Update (Paper #107)

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June 5, 2001 Joint Committee on Finance Paper #100

Indexing Top Bracket
(General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2001-03 Budget Summary: Page 21, #2]

CURRENT LAW

Under the 1999-01 biennial budget (1999 Wisconsin Act 9), a fourth income tax bracket was created, beginning in tax year 2000. Act 9 established the ceilings for the third bracket (and the corresponding floors for the fourth bracket), and provided that the amounts would be indexed for inflation, starting in 2001. Under the language in Act 9, the calculations of the ceilings for the third bracket for 2000 were based on changes in the Consumer Price Index (CPI) over 1997, which is the same way that the lower brackets are adjusted. But for 2001 and thereafter, Act 9 specified that the reference for the ceilings of the third bracket was the change in the CPI over 1999. While the intention was to adjust the brackets upward for increases in inflation, the actual effect was that the ceilings for the third brackets were lower for 2001 than for 2000.

GOVERNOR

Modify the indexing adjustment for the top individual income tax bracket for tax year 2002 and thereafter. Specify that, for tax year 2002 and thereafter, the ceilings for the third bracket would be indexed to the change in the CPI from 1997, rather than from 1999, as is the case for the other brackets and as would be consistent with the treatment of the ceilings for the third tax bracket for tax year 2000. The administration estimates that this provision would reduce general fund tax collections from the individual income tax by $450,000 in 2002-03.

MODIFICATION TO BILL

Reestimate the fiscal effect of this provision. Based on simulations with the 1999 Wisconsin tax sample, it is now estimated that this provision would reduce individual income tax

collections in 2002-03 by $750,000. Compared to the bill, the revised estimates would reduce general fund tax collections by $300,000 in 2002-03.

Explanation: The modification is based on more current information than was available at the time of the original estimate.

Modification	GPR
2001-03 REVENUE (Change to Bill)	- $300,000

Prepared by: Faith Russell

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June 5, 2001 | Joint Committee on Finance | Paper #101

Earned Income Tax Credit: Current Law Reestimates (General Fund Taxes -- Individual and Corporate Income Tax)

[LFB 2001-03 Budget Summary: Page 21, #3; Page 734, #36]

CURRENT LAW

The earned income tax credit (EITC) is offered at both the federal and state levels as a means of providing assistance to lower-income workers. The state EITC is calculated as a percentage of the federal credit and the state uses federal definitions and eligibility requirements for purposes of the EITC, except that the state does not provide a credit to individuals without children or advance payments of the credit. Both the federal and state credits are refundable. If the credit exceeds the amount of tax due, a check is issued for the difference.

The credit is calculated based on family size and on the amount of earned income (individuals without earned income are not eligible for the credit). Earned income includes wages, salaries and self-employment income; earned income does not include interest earnings, social security and welfare benefits. Individuals with more than a specified amount of disqualified income are not eligible for the credit. Disqualified income is interest (including tax-exempt interest), dividends, nonbusiness rents and royalties, net capital gains and net passive income. For tax year 2001, the disqualified income threshold is $2,450; this amount is adjusted each year for changes in inflation.

The income limits and maximum federal credit amounts are also adjusted annually for changes in inflation. The maximum federal credit for tax year 2001 is $2,428 for families with one child and $4,008 for families with two or more children. The state credit percentages are: 4% for families with one child; 14% for families with two children; and 43% for families with three or more children. Based on the 2001 federal credit parameters and the state credit percentages, the maximum state credits for 2001 are: $97 for families with one child; $561 for families with two children; and $1,723 for families with three or more children. The credit is not available

when adjusted gross income exceeds $28,281 for families with one child or $31,121 for families with two or more children.

Base funding for the EITC is $13,000,000 GPR and $54,000,000 PR, for a total of $67,000,000. The program revenue is federal temporary assistance for needy families (TANF) funding transferred from the Department of Workforce Development to pay the refundable portion of the EITC. The remaining funds are provided through a sum sufficient GPR appropriation. The TANF portion is based on the assumption that approximately 80% of EITC payments will be refunded to TANF-eligible individuals. In January, 2001, total EITC expenditures for 2000-01 were reestimated at $61,800,000.

GOVERNOR

Reduce EITC funding by the following amounts: (a) $744,500 GPR and $2,755,500 PR in 2001-02; and (b) $165,500 GPR and $334,500 PR in 2002-03. Total funding would be $63,500,000 in 2001-02 ($12,255,500 GPR and $51,244,500 PR) and $66,500,000 in 2002-03 ($12,834,500 GPR and $53,665,500 PR). TANF funding in DWD would be reduced by $2,755,500 FED in 2001-02 and $334,500 FED in 2002-03 to account for reduced costs of the credit.

MODIFICATION TO BILL

Reestimate funding for the EITC under current law for 2002-03 at $64,700,000 ($12,500,000 GPR and $52,200,000 PR). Compared to the bill, the revised estimate reduces funding for the second year by $334,500 GPR and $1,465,500 PR, for a total reduction of $1,800,000. Federal TANF funding in DWD would also be reduced by $1,465,500.

Explanation: The estimated cost of the state EITC is based on the anticipated inflationary adjustment of the federal credit parameters and historical growth in participation rates by Wisconsin residents. Based on current estimates of these factors, it is projected that the total cost of the state EITC will be $1,800,000 less in 2002-03 than is provided under the bill.

Modification	GPR	FED	PR	TOTAL
2001-03 FUNDING (Change to Bill)	- $334,500	- $1,465,500	- $1,465,500	- $3,265,500

Prepared by: Faith Russell

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June 5, 2001 | Joint Committee on Finance | Paper #102

Illinois-Wisconsin Income Tax Reciprocity Payments
(General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2001-03 Budget Summary: Page 23, #6]

CURRENT LAW

Wisconsin has an income tax reciprocity agreement with Illinois, under which residents of one state that work in the other are required to file a tax return and pay taxes only in the state of legal residence. In addition, Wisconsin and Illinois have a reciprocity payment agreement, under which a compensation payment is required when the net foregone tax revenues of one state exceed those of the other state. Under the payment provision, for tax years 2000 and thereafter, the amount of foregone tax revenue is computed on or before December 1 of the year following the close of the previous calendar year. For tax year 2000, the amount of the compensation payment will be determined on or before December 1, 2001, and paid during 2001-02.

GOVERNOR

Provide $11,750,000 GPR in 2001-02 and $12,500,000 GPR in 2002-03 to reflect estimated Illinois-Wisconsin tax reciprocity payments. [These funds were mistakenly placed in the appropriation for the Illinois income tax reciprocity benchmark study.]

DISCUSSION POINTS

1. Wisconsin currently has income tax reciprocity agreements with five states: Illinois, Indiana, Kentucky, Michigan and Minnesota. With these agreements, Wisconsin does not tax the wage and salary income earned in Wisconsin by residents of these states and instead collects taxes on income earned in these states by Wisconsin residents. Likewise, these other states do not impose their income tax on the earnings of Wisconsin residents and instead tax income earned in Wisconsin by their residents. As a result, Wisconsin foregoes tax revenue from residents of reciprocity states

who work here and the reciprocity states forego tax revenue from Wisconsin residents who work there.

2. The reciprocity agreements with Minnesota and Illinois require a compensation payment when the net foregone tax revenues of one state exceed those of the other state. The other three agreements do not include this provision.

3. Wisconsin has had an income tax reciprocity agreement with Illinois since 1973. The payment provision that applies to Illinois was enacted in 1997 Wisconsin Act 63 on April 1, 1998. The payment provision was adopted because Illinois officials stated that reciprocity with Wisconsin would be ended unless an agreement for payment was made.

4. As provided under Act 63, the Secretary of the Wisconsin Department of Revenue entered into a reciprocity agreement with the Director of the Illinois Revenue Department in 1998. The agreement provided for a benchmark study of 1998 tax returns to be conducted in 2000 and 2001, and specified that estimation of taxes foregone, payment amounts and adjusting payments were to use the study's methods and procedures. In addition, the agreement detailed procedures for data verification and reporting, the computation of interest on delinquent payments, impasse resolution and for modification to the agreement.

5. At the time that Act 63 was adopted, Illinois estimated that the state of Wisconsin was foregoing taxes of $13 million annually from Illinois residents working in Wisconsin and that Illinois was foregoing taxes of $24 million annually from Wisconsin residents working in Illinois. As provided under Act 63, Wisconsin made payments to Illinois of $5.5 million in 1998-99 and $8.25 million in 1999-00, which reflected 50% and 75%, respectively, of the $11 million annual revenue loss estimated by Illinois at that time. [The Wisconsin DOR had estimated that the difference in foregone taxes could be between $9.5 million and $29.0 million annually.] It was anticipated that subsequent payments, which were to be based on the results of the 1998 benchmark study (with an estimated completion date in 2000-01), would begin in 2001-02. No payment was made in the 2000-01 fiscal year.

6. Based on preliminary results of the benchmark study, the administration estimates payments to Illinois of $11,750,000 in 2001-02 and $12,500,000 in 2002-03. These payments are largely offset by tax collections from Wisconsin residents who work in Illinois

7. It should be noted that ending reciprocity with Illinois would result in lower income tax collections by an amount approximately equal to Wisconsin's payment because taxes would not be collected on the wages of Wisconsin residents working in Illinois.

MODIFICATION TO BILL

Reduce the amounts in the appropriation for the Illinois-Wisconsin income tax benchmark study by $11,750,000 GPR in 2001-02 and $12,500,000 GPR in 2002-03 and specify that these amounts would, instead, be provided under the sum sufficient appropriation for Illinois

income tax reciprocity payments. In addition, eliminate base funding of $50,700 GPR in each year for the Illinois-Wisconsin income tax benchmark appropriation.

Explanation: Under the bill, funding for the Illinois-Wisconsin reciprocity payments was mistakenly placed in the appropriation for the benchmark study. The modification would correct this error. The modification would also eliminate the $50,700 GPR base funding for 2001-02 and 2002-03 that is currently in the appropriation for the benchmark study. The administration indicates that the study is near completion and that its intent was to eliminate these amounts.

Modification	GPR
2001-03 FUNDING (Change to Bill)	- $101,400

Prepared by: Faith Russell

AGENCY: Corporate Income and Franchise Tax

ISSUE: Single Sales Factor paper 103

ALTERNATIVE: 3 (maintain current law)

SUMMARY:

Fiscal bureau makes a good argument (points 18 and 19) why single factor isn't a panacea, and more importantly, why it shouldn't be done without combined reporting (as done in Minnesota and Illinois).

Yes, many factors influence location decisions. A strong education system certainly is one that has been heavily lobbied by corporate leaders -- but some on this committee argued we can't afford better tech schools and a stronger university system.

Yes, we need to improve our tax climate, but homeowners come first, shareholders second.

We need a comprehensive approach, not piecemeal, lopsided approach.

By: Bob

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June 5, 2001 | Joint Committee on Finance | Paper #103

Corporate Income and Franchise Tax -- Single Sales Factor Apportionment Formula (General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2001-03 Budget Summary: Page 23, #9]

CURRENT LAW

Under Wisconsin law, formula apportionment is used to determine taxable income in Wisconsin if a corporation's Wisconsin activities are an integral part of a unitary business which operates both within and outside of the state. The apportionment ratio is the end result of the application of the Wisconsin apportionment formula to a particular corporation. For most corporations, the apportionment ratio or fraction is determined by dividing the corporation's property value, payroll and sales in Wisconsin by the corporation's total property value, payroll and sales, respectively. The apportionment ratio is determined by adding three fractions (referred to as the three factors of the formula)--the corporation's property in Wisconsin divided by its total property, the corporation's payroll in Wisconsin divided by its total payroll and the corporation's sales in Wisconsin divided by its total sales--double weighting the sales factor, and dividing the aggregate sum by four.

GOVERNOR

Phase in the use of a single sales factor apportionment formula to apportion to Wisconsin the income of corporations, including insurance companies, and nonresident individuals, and estates and trusts engaged in business within and outside of the state. Use of property and payroll to apportion income would be phased out. Use of single sales factor apportionment would be phased in over three years beginning with tax years beginning after December 31, 2002. For tax years beginning after December 31, 2004, a single sales factor apportionment formula would be used to apportion income to Wisconsin.

The phase-in of using a single sales factor apportionment formula would reduce corporate income and franchise tax revenues by an estimated $8,000,000 in 2002-03. Once fully phased-in in 2005, these provisions would reduce tax revenues by an estimated $80,000,000 per year.

DISCUSSION POINTS

1. The phase-in of the single sales factor apportionment formula would be accomplished as follows:

a. *Corporations, Nonresident Individuals, Estates and Trusts in General.* For tax years beginning before January 1, 2003, income would be apportioned using the current apportionment formula with the sales factor representing 50% of the apportionment ratio, the property factor representing 25%, and the payroll factor representing 25%. For tax years beginning after December 31, 2002, and before January 1, 2004, the apportionment ratio would be calculated with the sales factor representing 60% of the apportionment ratio, the property factor representing 20%, and the payroll factor representing 20%. For tax years beginning after December 31, 2003, and before January 1, 2005, the apportionment ratio would be calculated with the sales factor representing 80% of the apportionment ratio, the property factor representing 10%, and the payroll factor representing 10%. For tax years beginning after December 31, 2004, a single sales factor apportionment formula would be used to apportion income to Wisconsin.

b. *Financial Institutions.* For tax years beginning before January 1, 2003, income would be apportioned using the current apportionment formula (specified by administrative rule) with a gross receipts factor representing 50% of the apportionment ratio and a payroll factor representing 50% of the apportionment ratio. For tax years beginning after December 31, 2002, and before January 1, 2005, the apportionment ratio would be calculated with a sales factor that represented more than 50% of the apportionment ratio as determined by administrative rule by DOR. For tax years beginning after December 31, 2004, a single sales factor apportionment formula would be used to apportion income to the state as determined by administrative rule by DOR. The Department would be required to promulgate administrative rules governing the apportionment of the income of financial organizations and submit them to the Legislative Council by the first day of the fourth month beginning after the effective date of the bill.

c. *Insurance Companies.* The method used for calculating the Wisconsin net income of taxable insurers would be modified to use an apportionment ratio based on premiums and payroll in Wisconsin and to apply that ratio to federal total taxable income. Specifically, the premiums factor of the apportionment formula would be the ratio of direct premiums and assumed premiums written for reinsurance with respect to property and risks resident, located or performed in the state, divided by the total of such premiums everywhere. "Direct premiums" would be defined as direct premiums reported for the tax year on the annual statement required to be filed with the Commissioner of Insurance. "Assumed premiums" would be defined as assumed reinsurance premiums from domestic insurance companies reported for the tax year also on the annual statement required to be filed with the Commissioner of Insurance. The payroll

factor would be the ratio of payroll in Wisconsin to total payroll everywhere. The arithmetic average of the premiums and payroll ratios would be applied to federal taxable income to determine Wisconsin net income.

Currently, income is apportioned to Wisconsin by first calculating the arithmetic average of the ratio of premiums outside Wisconsin to total premiums and the ratio of payroll outside Wisconsin to total payroll. This ratio is then applied to federal taxable income and the resulting amount is subtracted from federal taxable income to determine Wisconsin taxable income.

For tax years beginning before January 1, 2003, income would be apportioned with the premiums factor representing 50% of the apportionment ratio and the payroll factor representing 50%. For tax years beginning after December 31, 2002, and before January 1, 2004, income would be apportioned with the premiums factor representing 60% of the apportionment ratio and the payroll factor representing 40%. For tax years beginning after December 31, 2003, and before January 1, 2005, income would be apportioned with the premiums factor representing 80% of the apportionment ratio and the payroll factor representing 20%. For tax years beginning after December 31, 2004, income would be apportioned using only the premiums factor.

d. *Gas, Electric and Telecommunications Utilities.* These companies would be subject to the same apportionment provisions as corporations in general. Under current law, all public utilities are subject to apportionment under rules promulgated by DOR.

e. *Other Public Utilities.* Interstate railroads, motor carriers, air carriers, sleeping car, carline and pipeline companies would continue to apportion income under current law provisions.

2. The state corporate income tax was first introduced in Wisconsin in 1911 and over the next ten years, seven more states--Connecticut, Virginia, Missouri, Montana, New York, Massachusetts, and North Dakota--enacted the tax. Currently, 45 states have a corporate income tax; Nevada, Texas, South Dakota, Washington and Wyoming do not have a corporate income tax. Since the tax was first imposed, one of the more difficult problems in administering the tax has been allocating a portion of the income of a corporation doing businesses in several states to a particular state for tax purposes. Initially, most states used separate accounting to allocate corporate income. However, because of the difficulty in determining income from intercompany transactions and attributing expenses to specific activities in individual states, most states adopted apportionment formulas to allocate multistate corporate income.

3. The earliest state apportionment formulas used only a single factor, usually property. However, by the 1930s the most widely used formula was one that originated in Massachusetts and consisted of three factors: property, payroll and sales (or gross receipts). There were wide variations in the way states defined these factors. For many years, states continued to use the three-factor formula with each factor evenly weighted. The standard approach was to use the formula adopted by the Uniform Division of Income for Tax Purposes Act (UDITPA) in 1957. The formula was a political compromise between manufacturing states in the east and the market states in the west. In addition, states adopted special apportionment formulas to apply to businesses, such as banking,

financial services and insurance, for which the traditional three-factor formula was not well suited. Over time, however, most states modified the standard three-factor formula to double-weight the sales factor. More recently, some states have begun to use a single-sales factor apportionment formula, at least for some industries.

4. Table 1 shows the apportionment formulas that are generally applied to corporations in the states. The table shows that 24 states use a double-weighted sales factor and another four states give greater weight to sales. Currently, Illinois, Iowa and Nebraska use a single-sales apportionment formula.

TABLE 1

State Apportionment Formulas
January 1, 2001

State	Formula
Alabama	3 Factor
Alaska	3 Factor
Arizona	Double wtd. sales
Arkansas	Double wtd. sales
California	Double wtd. sales
Colorado	3 Factor/Sales & Property
Connecticut	Double wtd. sales/Sales
Delaware	3 Factor
Florida	Double wtd. sales
Georgia	Double wtd sales
Hawaii	3 Factor
Idaho	Double wtd. sales
Illinois	Sales
Indiana	Double wtd. sales
Iowa	Sales
Kansas	3 Factor/Sales & Property
Kentucky	Double wtd. sales
Louisiana	Double wtd. sales
Maine	Double wtd. sales
Maryland	Double wtd. sales
Massachusetts	Double wtd. sales/Sales
Michigan	90% sales, 5% property and payroll
Minnesota	75% sales, 12.5% property and payroll
Mississippi	Accounting/3 Factor
Missouri	3 Factor/Sales
Montana	3 Factor
Nebraska	Sales
Nevada	No State Income Tax
New Hampshire	Double wtd.sales
New Jersey	Double wtd. sales
New Mexico	Double wtd. sales
New York	Double wtd. sales
North Carolina	Double wtd. sales
North Dakota	3 Factor
Ohio	60% Sales, 20% Property & Payroll
Oklahoma	3 Factor
Oregon	Double wtd. sales
Pennsylvania	Triple wtd. sales
Rhode Island	3 Factor
South Carolina	Double wtd. sales/Sales
South Dakota	No State Income Tax
Tennessee	Double wtd. sales
Texas	No State Income Tax
Utah	3 Factor
Vermont	3 Factor
Virginia	Double wtd. sales
Washington	No State Income Tax
West Virginia	Double wtd. sales
Wisconsin	Double wtd. sales
Wyoming	No State Income Tax
Dist. Of Columbia	3 Factor

Source: Compiled by Federation of Tax Administrators (FTA) and other sources.
Note: Formulas listed are for general manufacturing businesses. Some industries have special apportionment formulas that may differ from the reported formulas.

5. In order for a state to impose a tax on a corporation engaged in interstate commerce, the tax must meet the tests of both the Commerce and Due Process Clauses of the U.S. Constitution.

The U.S. Supreme Court has ruled (Complete Auto Transit Inc. v Brady, 1977) that a state tax meets the requirements of the Commerce Clause if: (a) the taxed activity is sufficiently connected with the taxing state to justify a tax; (b) the tax is fairly related to benefits provided by the state; (c) the tax does not discriminate against interstate commerce; and (d) the tax is fairly apportioned. Similarly, the Court stated in Mobil Oil Corp. v. Commissioner of Taxes of Vermont (1980) that the Due Process Clause imposes two limitations on a state's exercise of jurisdiction over a nonresident taxpayer: (a) the taxpayer must have minimum contacts with the taxing state; and (b) there must be a rational relationship between the income attributed to the state and the intrastate value of the enterprise. These principles lend support to the use of apportionment formulas to allocate the income of multistate firms.

6. The U.S. Supreme Court has generally upheld formula apportionment as an appropriate way to allocate the income of a multistate corporation to a particular state. In Butler Brothers v McColgan (1942), the Court ruled that California's three-factor apportionment formula based on property, payroll and sales was "fairly calculated" to assign to the taxing state that portion of net income "reasonably attributable" to the business done there. The Supreme Court has indicated that the three-factor apportionment formula has become "something of a benchmark against which other apportionment formulas are judged" (Container Corp. of America v Franchise Tax Board, 1983). However, the Court has approved many different apportionment methods and has declined to mandate a uniform method in all states. The Court has recognized that the lack of uniformity in apportionment practices of the states creates a risk of overlapping taxes on interstate commerce, but has insisted that Congress should decide whether there is an overriding national interest in uniformity, and if so what the rules should be. For example, in Moorman Mfg. Co. v Bair, (1978), the Court upheld Iowa's single-sales factor formula against challenges under the Due Process and Commerce Clauses. The Court found that the formula method of computing taxable income is employed as a rough approximation of a corporation's income that is reasonably related to a taxpayer's activities conducted within the taxing state.

7. In order to use an apportionment formula to compute tax liability, the taxpayer's activities within and outside the state must be part of a unitary business. If the activities are separate and discrete, the income from the in-state activities can be determined by separate accounting and the formula method is neither necessary nor appropriate. In addition, apportionable income needs to be determined. Formula apportionment spreads the income of the corporation over all the states where the principal business activity occurs. Therefore, only income which bears reasonably close connection to the central business should be included in income that is apportioned. If the business has income from property or activities only remotely connected with the central business, it may be more appropriate to allocate the income specifically to the situs of the property or the activity that produced it.

8. Wisconsin generally employs one of three methods of assigning income to the state--separate accounting, formula apportionment or specific allocation.

Separate Accounting. Under separate accounting, a geographic or functional area of a single, multistate corporation is treated separately from the rest of the business activities of the

corporation. Net income is computed as if the activities of the corporation were confined to that geographic or functional area. Separate accounting implies that both the income and expenses of each specific function or activity of a multijurisdictional corporation can be accounted for individually and independently. Under Wisconsin law, a multijurisdictional corporation may use separate accounting when the corporation's business activities in the state are not an integral part of a unitary business. Generally, a unitary business exists when the corporation's in-state activities are dependent upon, or contributory to, the operations outside of Wisconsin. Currently, few multijurisdictional corporations in the state use separate accounting to determine their net tax liability.

Formula Apportionment. Under the formula apportionment method of assigning corporate income, a formula is employed for dividing the income of a multistate corporation among the states in which its business is conducted. States have developed apportionment formulas as a rough means of attributing a reasonable share of the income tax base of a multistate unitary business to the taxing state. Under Wisconsin law, formula apportionment is used if a corporation's Wisconsin activities are an integral part of a unitary business which operates both within and outside of the state.

Specific Allocation. Specific allocation traces income to the state of its supposed source and includes the income in that state's tax base. Generally, this method of assigning income is applied to income from property with the source of the income generally following the location of the property. Wisconsin law distinguishes nonapportionable income from apportionable income. In determining a corporation's tax liability, total corporate nonapportionable income or loss is removed from the total income of a unitary multistate corporation and the remaining income or loss is apportioned to the state. Nonapportionable income allocated to Wisconsin is then added to apportioned business income to determine Wisconsin net income. Nonapportionable income is allocable directly to the state in which the nonbusiness property that produced the income, gain or loss is located. For state income and franchise tax purposes, nonapportionable income includes income, gain or loss from: (a) the sale of nonbusiness real property or nonbusiness tangible personal property; (b) rental of nonbusiness real property or nonbusiness tangible personal property; or (c) royalties from nonbusiness real property or nonbusiness tangible personal property.

9. Most multistate or multinational corporations use the state apportionment formula to allocate income to Wisconsin for tax purposes. In these cases, the corporation adds its total gross income from its in-state and out-of-state unitary activities, subtracts its deductions, and multiplies the amount of net income by its apportionment ratio as determined by the Wisconsin apportionment formula. The apportionment ratio is used to approximate how much of a corporation's total net income is generated by activities in Wisconsin. Figure I provides an illustration of the Wisconsin apportionment formula under current law.

FIGURE I

Computation of Apportionment Percentage
Under the Current Wisconsin Apportionment Formula

$$\text{Apportionment Percentage} = \left[\left[\frac{\text{Property in WI}}{\text{Total Property}} \right] + \left[\frac{\text{Payroll In WI}}{\text{Total Payroll}} \right] + 2 \left[\frac{\text{Sales by WI Destination}}{\text{Total Sales}} \right] \div 4 \right]$$

10. The property factor of the apportionment formula is the ratio of the average value of real and tangible personal property owned or rented and used by the taxpayer in Wisconsin to that for the company as a whole. Tangible property includes land, buildings, machinery and equipment, inventories, furniture and fixtures and other tangible personal property actually owned and used in producing apportionable income.

11. The payroll factor is the ratio of the total amount of compensation paid by the company in the state to the total compensation paid by the company. Compensation includes wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

12. The sales factor is the ratio of the total sales of the taxpayer in the state to total sales everywhere. Sales are generally all gross receipts from the course of the taxpayer's regular trade or business operations which produce apportionable business income. For the sales factor, sales of tangible personal property are generally considered to be in Wisconsin if the property is delivered or shipped to a purchaser within Wisconsin or if the property is shipped from Wisconsin and the taxpayer is not subject to the taxing jurisdiction of the state of destination. The latter type of sales are "throwbacks" and single-weighted in the apportionment formula. In addition, sales of tangible personal property from an office in the state, but shipped from an out-of-state supplier to an out-of-state customer are considered throwback sales if neither the supplier nor the customer are subject to the taxing jurisdiction of the states in which they are located. Sales to the federal government are only considered to be in Wisconsin if they are shipped from a location within the state and are delivered to the federal government at a location within the state or if they are "throwback" sales. Federal throwback sales are single-weighted in the apportionment formula. Sales other than sales of tangible personal property are usually considered to be in Wisconsin if the income-producing activity is performed wholly in Wisconsin. Generally, sales of intangible assets are excluded from the sales factor. Sales which produce nonapportionable income are also excluded from the sales factor.

13. Interstate air carriers, motor carriers, pipeline companies, taxable insurance

companies and financial organizations are required to use different apportionment formulas to determine Wisconsin net taxable income. These corporations must use special apportionment factors in order to attribute income to their Wisconsin business activities. Public utilities for which an apportionment formula is not specified are required to use the arithmetic average of the ratios of the regular three-factor (payroll, property, sales) formula to apportion income to the state. Thus, generally, public utility companies apportion income using the average of the ratios of payroll, property and sales in-state to total payroll, property and sales. The sales factor is not double-weighted.

14. Instituting a single-sales factor apportionment formula would have no effect on the taxes paid by corporations whose business property, operations and income are entirely in Wisconsin, because these corporations do not use an apportionment formula to determine tax liability. Most corporate taxpayers do not apportion income and, as a result, most businesses in Wisconsin would not directly benefit from a change to single-sales factor apportionment. However, if the change in the apportionment formula decreases total corporate income and franchise taxes, then 100% Wisconsin corporations would pay a larger proportionate share of the remaining total collections.

15. Although most corporations operating in Wisconsin are not multistate or multinational firms, substantially more taxes are paid by firms that apportion income. Table 2 shows the distribution of net income and tax liability for corporations that apportion income compared to the totals for all corporations. The data is from 1999 corporate aggregate statistics and shows that multijurisdictional firms represented about 17% of all corporate taxpayers but paid $419.7 million or 73% of total corporate income taxes.

TABLE 2

Distribution of Net Income and Tax Liability of Multistate Corporations (1999)

	Multistate Corporations			All Corporations		
Net Income Class	Net Income	Net Tax	Corporations	Net Income	Net Tax	Corporations
Zero or Less	$0	$0	10,369	$0	$0	80,492
0--10,000	7,242,898	566,991	2,628	31,112,167	2,420,421	10,045
10,000--25,000	14,861,367	1,162,711	911	67,766,082	5,249,185	4,113
25,000--50,000	24,613,301	1,935,445	683	122,171,304	9,422,233	3,353
50,000--100,000	49,907,111	3,829,109	693	200,546,540	15,398,276	2,860
100,000-250,000	119,483,341	9,066,694	749	310,351,072	23,537,067	2,002
250,000-500,000	160,263,472	11,860,972	452	338,077,095	25,377,420	953
500,000--1,000,000	230,804,378	17,126,465	325	457,396,078	34,210,314	647
1,000,000-5,000,000	1,214,336,941	86,908,088	538	1,718,907,961	125,883,666	811
5,000,000--10,000,000	767,739,173	53,981,004	107	870,417,921	62,076,758	121
10,000,000+	3,390,106,785	233,222,765	97	3,918,955,632	274,991,940	111
Total	$5,979,358,767	$419,660,244	17,552	$8,035,701,852	$578,567,280	105,508

16. Compared with the current three-factor formula, the single-sales factor apportionment formula would increase the tax on some multijurisdictional corporations and decrease it on others. The exact pattern of the effects depends on the mathematical relationship between the sales factor and the property and payroll factors. Specifically, corporations whose sales factors are less than the average of their property and payroll factors would benefit from a move to a single-sales factor apportionment formula; corporations whose sales factors are greater than the average of their property and payroll factors would be disadvantaged. Data developed by the Department of Revenue from 1999 corporate income and franchise tax returns for which specific apportionment data was available indicates that the total decrease in tax liability from switching to a single-sales factor apportionment formula would have been $79.7 million. However, 4,259 firms would have experienced an aggregate tax increase of $47.1 million ($11,055 average); while 2,141 would have experienced a total tax decrease of $115.3 million ($53,867 average). This data does not include corporations that would experience a tax change but for which information was insufficient to calculate a specific change in liability.

17. Replacing the current three-factor formula with a single-sales factor apportionment factor would reduce taxes on corporations that have a substantial amount of their production activities in the state. The single-sales factor would reduce the tax impact on multistate businesses that place jobs and capital in-state by giving them lower tax bills than would occur under the three-factor method of apportionment. On a more specific level, Wisconsin's current three-factor formula creates a disincentive for businesses that require large investments in tangible property and payroll to locate in the state, when compared with the surrounding states. Iowa and Illinois use a single-sales apportionment factor and Michigan is phasing in such a formula. Minnesota attributes a 70% weight to the sales factor. All of these apportionment formulas place a relatively lower income tax burden on property and payroll than Wisconsin's. Because of these impacts, converting to a single-sales factor is viewed as a means of generating economic growth. A 2000 study conducted by economists Austau Goolsbee, Edward Maydew and Michael Schadewald estimated that switching to a single-sales factor apportionment formula in Wisconsin would have the long run effect of increasing the number of manufacturing jobs by about 2.9% or 18,000 jobs. Nonmanufacturing employment would increase 2.4% or by 49,000 new jobs. Also, $51 million in additional tax revenue would be generated. The study was based on experiences of other states that modified their apportionment formulae between 1978 and 1995 and controlled for other factors that could affect employment.

18. A business that sells a substantial amount of its products and also has some business operations in-state would have less incentive for keeping those operations here under single-sales factor apportionment. Moreover, there would be an incentive for many firms that sell tangible personal property in the state to reduce in-state operations solely to the solicitation of orders to be protected from taxation under federal law relating to corporate nexus (Public Law 86-272). This, in turn, would make it even less likely that the business would locate property or production personnel in the state. In addition, there are a number of elements in a state's tax code that are equally or more important in determining the relative tax burden on businesses in different states. For example, both Illinois and Minnesota require multistate corporations to use combined reporting in determining state tax liability. For many firms, this method has a greater impact on tax burden than the type of

apportionment formula used. Finally, the two states that have used single-sales factor apportionment the longest, Iowa and Nebraska, have not had relatively greater increases in investment than surrounding states. These states have not become regional manufacturing centers.

19. The Department of Revenue has recommended technical changes to address the computation of the sales factor when the denominator or numerator is negative or zero. The Committee may wish to adopt those recommended changes to clarify computation of the sales factor in those circumstances.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to phase in the use of a single sales factor apportionment formula to apportion to Wisconsin the income of corporations, including insurance companies, and nonresident individuals, and estates and trusts engaged in business within and outside of the state. Provide that use of single sales factor apportionment would be phased in over three years beginning with tax years beginning after December 31, 2002. Require, for tax years beginning after December 31, 2004, use of a single sales factor apportionment formula to apportion income to Wisconsin.

2. Adopt technical changes to address computation of the sales factor when the numerator or denominator in the apportionment formula is negative or zero.

3. Maintain current law.

Alternative 3	GPR
2001-03 REVENUE (Change to Bill	$8,000,000

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June 5, 2001 | Joint Committee on Finance | Paper #104

Corporate Income and Franchise Tax -- Tax Treatment of Corporate Partners and LLC Members (General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2001-03 Budget Summary: Page 28, #10]

CURRENT LAW

Under current law, a corporation that is not doing business in Wisconsin and that holds an interest in a partnership or limited liability company (LLC) that is doing business in the state is not subject to the state corporate income and franchise tax if its interest is not an extension of the corporation's business.

GOVERNOR

Modify current corporate income and franchise tax provisions related to the tax treatment of corporations that are partners or members of limited liability companies as follows:

a. Define "doing business in this state" to include owning, directly or indirectly, a general or limited partnership interest in a partnership that does business in the state or an interest in an LLC that does business in the state, regardless of the percentage of ownership.

b. Provide that, for state income and franchise tax purposes, a general or limited partner's share of the numerator and denominator of a partnership's apportionment factors would be included in the numerator and denominator of the general or limited partner's apportionment factors. Similarly, for an LLC treated as a partnership, a member's share of the numerator and the denominator of an LLC's apportionment factors would be included in the numerator and denominator of the member's apportionment factors.

These provisions would first apply to tax years for partners or LLC members that begin on January 1, 2001.

These provisions would increase corporate income and franchise tax revenues by an estimated $7,500,000 in 2001-02 and $5,000,000 in 2002-03. The higher figure in the first year includes one-time revenues of $2,500,000 from reconciling estimated and final tax payments.

DISCUSSION POINTS

1. The tax treatment of corporations that are partners or LLC members depends on the location of the corporation's and partnership's or LLC's activities and whether or not the partnership or LLC is an extension of the corporation's business:

a. Corporate Partners or Members Engaged in Business Wholly within Wisconsin. A corporation that is engaged in business wholly within Wisconsin and that is a partner or member of an LLC is required to include its share of partnership or LLC net income in its Wisconsin net income or loss. For a corporation engaged in business wholly in Wisconsin, all income is subject to the Wisconsin corporate income and franchise tax.

b. Corporate Partners or Members Engaged in Business Both In and Outside Wisconsin. A corporation that is engaged in business both in and outside of Wisconsin and that is a partner or member of a partnership or LLC is generally required to include its share of partnership or LLC income in its apportionable income or loss. However, computation of the corporation's apportionment factors depends on whether or not the corporation's interest in the partnership or LLC is an extension of the corporation's business. If the partnership or LLC is an extension of the corporation's business, the corporation combines its share of the partnership's or LLC's apportionment formula factors (property, payroll and sales) in the numerator and denominator of its apportionment factors to determine the income that is allocated to the state. If the corporation's ownership interest in the partnership or is not an extension of the corporation's business, no part of the partnership's or LLC's property, payroll or sales are included with the corporation's apportionment factors.

c. Corporate Partners or Members not Engaged in Business in Wisconsin. A corporation that is not otherwise engaged in business in Wisconsin and that is a partner or a member of partnership or LLC that is engaged in business in Wisconsin is subject to taxation on its share of partnership or LLC income only if the partnership or LLC is an extension of the corporation's business. If the partnership or LLC is an extension of the corporation's business the corporate partner or member is engaged in business in Wisconsin as a result of holding an interest in the partnership or LLC. The corporation's share of the partnership's or LLC's income or loss is taxable under the state corporate income and franchise tax. In addition, the corporate partner or member includes its share of the partnership's or LLC's formula factors in determining the income that is allocated to Wisconsin. If a corporate partner or member has an interest in a partnership or LLC that is not an extension of the corporation's business, the corporation is not subject to Wisconsin income

or franchise taxation. The corporation is not considered to be engaged in business in Wisconsin based on its interest in the partnership or LLC.

2. The term "extension of the corporation's business" is not clearly defined. If the corporation is a general partner in a partnership, the partnership is deemed an extension of the corporation's business since a general partner has unlimited liability, and management and control rights in a partnership. In cases where the corporation is a limited partner or LLC member, facts and circumstances determine whether the partnership or LLC is considered an extension of the corporation's business.

3. An individual partner's or LLC member's (including nonresidents) portion of partnership or LLC income or loss that is attributable to a business located in Wisconsin, services performed in Wisconsin, or real or tangible property located in Wisconsin must be included in computing Wisconsin taxable income. For individual partners or members, business income is taxable under the Wisconsin individual income tax whether or not the individual conducts business in Wisconsin.

4. Under current law, determination of whether a corporation's interest in a partnership or LLC is an extension of the corporation's business is generally made on a case-by-case basis which makes it difficult for taxpayers to comply with and the Department of Revenue (DOR) to administer. In addition, the complexity in determining if a partnership or LLC is an extension of the corporation's business can allow businesses to restructure their operations to avoid paying corporate franchise and income taxes on income generated by Wisconsin business activities.

5. The following is an example that illustrates how a corporation could restructure its activities to avoid taxation in Wisconsin. ABC Corporation, a Delaware corporation, has been engaged in a retail business in Wisconsin. ABC Corporation restructures its activities by putting its Wisconsin retail operations into XYZ limited partnership and transferring the ownership in this limited partnership in two newly created, wholly-owned subsidiaries, S1 and S2, that are incorporated in Delaware. S1's only activity is to hold 1% general partnership interest in XYZ. S2's only activity is to hold a 99% limited partnership interest in XYZ. As a result of this restructuring, ABC is generally no longer subject to Wisconsin franchise or income tax. XYZ limited partnership is doing business in Wisconsin, but is not subject to tax because it is a pass-through entity. As a partnership, XYZ's income, losses, and deductions pass through to S1 and S2.

As noted, under current law, a corporation would be treated as doing business in Wisconsin as a result of holding an interest in a partnership that does business in Wisconsin only if the partnership is an extension of the corporation's business. S1 would be treated as doing business in Wisconsin as a result of holding a general partnership interest in XYZ, which is engaged in retail activities in the state. XYZ would be considered an extension of S1's business. S1's 1% share of XYZ's Wisconsin net income would be subject to the state income and franchise tax. However, it is likely that S2 would not be considered to be doing business in Wisconsin. XYZ would not be an extension of S2's business. Therefore, S2 would not be required to file a Wisconsin corporation tax return and its 99% share of XYZ's income would not be subject to taxation in the state. Note that if

XYZ's interests were held by individuals rather than by a corporation, the 99% share of limited partnership income would be subject to the state income tax. The example shows that, under current law, ABC corporation was able to restructure and avoid Wisconsin taxation of 99% of its income from retail activities in the state.

6. Tax practitioners have indicated that the proposed law change could have some unintended negative effects that would reduce state tax revenues. First, Wisconsin corporations whose business activities are entirely in-state other than a limited interest in an out-of-state partnership or LLC generally include all of the income from the out-of-state entity in Wisconsin net income subject to the state corporate income tax. The corporation is not treated as doing business in the state in which the partnership or LLC operates and the income from the out-of-state entity is treated as investment income taxable to Wisconsin. However, under the proposed tax law change, the corporation would be considered as doing business in the state in which the partnership or LLC was located and the corporation's income would be subject to apportionment. As a result, only a portion of the income from the out-of-state entity would be allocated to Wisconsin for tax purposes. There is also concern that the proposed law change could be subject to court challenge because the ownership interest that would be used to impose the state corporate income tax would not constitute sufficient nexus for the state to impose the tax. In addition, some believe the change would result in the state taxing income derived from business transacted in Wisconsin. This would make the corporate income and franchise tax similar to the individual income tax, rather than being a tax imposed on the exercise of a franchise or income from doing business in the state. This could lead to a court challenge that could question the state's ability to tax income from federal obligations under the corporate franchise tax.

7. The Department of Revenue has suggested modifications to the statutory provisions included in the bill. The Department recommends specifying that owning an LLC would be considered doing business in the state only if the LLC is treated as a partnership for federal income tax purposes. This would clarify that an LLC treated as a corporation would be subject to tax as a separate entity just as a subsidiary corporation is. DOR also recommends including a severability provision, such as the phrase "subject to constitutional limitations", so that any court ruling that the definition is unconstitutional when applied to a particular set of facts would not invalidate the statute in other cases.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to modify current corporate income and franchise tax provisions related to the tax treatment of corporations that are partners or members of limited liability companies to define "doing business in this state", and specify the treatment of a partnership or LCC's apportionment factors.

2. Approve the Governor's recommendation and specify that owning an LLC would be considered doing business in the state only if the LLC is treated as a partnership for federal income tax purposes and include a severability provision in the definition of "doing business."

3. Maintain current law.

Alternative 3	GPR
2001-03 REVENUE (Change to Bill)	- $12,500,000

Prepared by: Ron Shanovich

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June 5, 2001 | Joint Committee on Finance | Paper #105

Milwaukee Development Opportunity Zone and Capital Investment Credit (General Fund Taxes -- Individual and Corporate Income and Franchise Taxes)

[LFB 2001-03 Budget Summary: Page 29, #12]

Alt 1 (this is the Boston Store/WEPCO tax credit)

CURRENT LAW

Wisconsin has two programs that provide tax credits to businesses as incentives to expand and locate in designated economically distressed areas: development zones and enterprise development zones. The programs are designed to promote economic growth through job creation and investment in the distressed areas. Designation criteria target areas with high unemployment, low incomes and decreasing property values. Businesses which locate or expand in the different zones are eligible to claim the development zone jobs and environmental remediation tax credits. The Department of Commerce has designated 20 development zones and certified 40 enterprise development zones. Commerce has authority to designate a total of 22 development zones and 79 enterprise development zones. In addition, an area in the City of Kenosha has been designated as a development opportunity zone.

GOVERNOR

Designate an area in the City of Milwaukee as a development opportunity zone. The Milwaukee development opportunity zone would exist for seven years, beginning with the effective date of the bill. Any corporation that conducted economic activity in the zone and that, in conjunction with the Common Council of the City of Milwaukee, submitted a project plan would be eligible to claim the development zone tax credit, the development zone investment credit and a development zone capital investment credit that would be created in the bill. The maximum amount of tax credits that could be claimed by businesses in the zone would be $4.7 million. (This provision is designed to provide assistance to Saks Fifth Avenue for the Grand Avenue Boston Store location in Milwaukee.)

DISCUSSION POINTS

1. Under the bill, in order to claim tax credits, a corporation that conducts or intends to conduct economic activity in the Milwaukee development opportunity zone would have to submit a project plan to Commerce, in conjunction with the Common Council. The project plan would have to include: (a) the name and address of the corporation's business for which tax benefits will be claimed; (b) the federal tax identification number of the business; (c) the names and addresses of other locations outside the development opportunity zone where the corporation conducts business and a description of the business activities at those locations; (d) the amount the corporation proposes to invest in a business, or spend on the construction, rehabilitation, repair or remodeling of a building located in the development opportunity zone; (e) the estimated total investment of the corporation in the development opportunity zone; (f) the number of full-time jobs that would be created, retained or substantially upgraded as a result of the corporation's economic activity in relation to the amount of tax benefits estimated for the corporation; (g) the corporation's plan to make reasonable attempts to hire employees from the targeted population [public assistance recipients and other economically disadvantaged individuals]; (h) a description of the commitment of the Milwaukee Common Council to the corporation's project; (i) any other information required by Commerce or the Department of Revenue (DOR).

2. The bill would create a development zone capital investment tax credit that would only be available to a business in the Milwaukee development opportunity zone. The credit would equal 3% of the following:

a. *The purchase price of depreciable, tangible personal property.* To be eligible for the credit, the property would have to be purchased after the claimant was certified as eligible for tax benefits and the personal property would have to have at least 50% of its use in the claimant's business at a location in the development opportunity zone. If the property was mobile, the base of operations for at least 50% its use would have to be in the development opportunity zone.

b. *The amount expended to acquire, construct, rehabilitate, remodel, or repair real property in the development opportunity zone.* Expenses would be eligible for the credit if the claimant began the physical work of construction, rehabilitation, remodeling or repair, or any demolition or destruction in preparation for the physical work, after the place where the property is located was designated a development opportunity zone. Expenses could be claimed for the credit if the completed project was placed in service after the claimant was certified as eligible for tax benefits. A credit could not be claimed for expenses for preliminary activities such as planning, designing, securing financing, researching, developing specifications, or stabilizing the property to prevent deterioration.

A claimant could also claim a tax credit for amounts expended to acquire real property, if the property was not previously owned and the claimant acquired the property after the place where the property was located was designated a development opportunity zone or if the completed project was placed in service after the claimant was certified as eligible for tax

benefits. Property would be considered previously owned if the claimant or a related party owned the property during the two years prior to Commerce designating the place where the property was located as a development opportunity zone. In addition, the property would have to be subject to the federal prohibition on the deductibility of losses on the sale or exchange of such property to related parties. However, the federal 50% ownership interest threshold for determining a related party would be eliminated so that any interest in another entity would make it a related party.

In calculating the capital investment credit for purchases of real property, a claimant would be required to reduce the amount expended to acquire the property by a percentage equal to the percentage of the area of the real property that is not used for the purposes for which the claimant is certified for tax benefits. Similarly, the amount expended for other purposes would be reduced by the amount expended on the part of the property not used for purposes for which the claimant is certified.

Credits that were not entirely used to offset income or franchise taxes in the current year could be carried forward up to 15 years to offset future tax liabilities. Internal Revenue Code (IRC) provisions would govern the carry-forward of unused credits in cases where there was a change of ownership.

3. Partnerships, LLCs and S corporations could not claim the credit as an entity, but eligibility for, and the amount of credit, would be based on the entity's economic activity. Partners, members of LLCs, and shareholders of S corporations could claim the capital investment tax credit based on the entity's activities in proportion to their ownership interest. The corporation, partnership or limited liability company would be required to compute the amount of credit that could be claimed by each of the entity's shareholders, partners and members, respectively, and provide this information to them. The shareholders, partners and LLC members could use the credit to offset the tax attributable to their income from the partnership's, company's or corporation's business operations in the development zone or their income from the entity's directly related business operations.

4. Under current law, eligible businesses which conduct economic activity in development or enterprise development zones may claim the development zone tax credit. A business in the Milwaukee development opportunity zone would be eligible for the tax credit. The credit is based on amounts spent on environmental remediation and the number of full-time jobs created or retained.

a. *Environmental Remediation Component.* A credit against income taxes due can be claimed for 50% of the amount expended for environmental remediation in a development, or enterprise development zone.

b. *Full-Time Jobs Component.* A credit of up to $8,000 against income and franchise taxes can be claimed for: (a) each full-time job created in a development or enterprise development zone and filled by a member of a targeted group; and (b) retaining a full-time job in

an enterprise development zone if Commerce determines that a significant capital investment was made to retain the full-time job. In addition, a credit of up to $6,000 can be claimed for each full-time job created or retained in a development or enterprise development zone that is filled by a Wisconsin resident who is not a member of a targeted group.

Credits that are not entirely used to offset income or franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities.

5. An eligible corporation in the Milwaukee development opportunity zone could claim a credit against income taxes due for 2.5% of the purchase price of depreciable tangible personal property or 1.75% of the purchase price of depreciable tangible personal property that was expensed under section 179 of the IRC. Only taxes due on income generated by or directly related to business activities in the development opportunity zone could be offset by the credit. Unused credit amounts could be carried forward to offset future tax liabilities generated by activities in the development opportunity zone. However, if the business ceased operations in the zone, unused credit amounts could not be carried forward.

6. Commerce would be required to revoke the entitlement for tax credits of a corporation that: (a) supplied false or misleading information to obtain the tax benefits; (b) left the zone to conduct substantially the same business outside the development opportunity zone; or (c) ceased operations in the zone and did not renew the same or similar operations within 12 months. Annually, Commerce would be required to estimate the amount of revenue that would be forgone due to tax credits claimed by businesses in the development opportunity zone. The zone would expire 90 days after the day on which Commerce determined that the amount of forgone revenue equaled or exceeded the $4.7 million tax credit limit.

7. Commerce would be authorized to certify a person that was conducting economic activity in the development opportunity zone as eligible for claiming the available tax credits based on the economic activity of another person. (This is intended to address cases where a person developed a business location for lease to another business and the lessee business created jobs but could not claim the jobs component of the development zones credit.) In order for Commerce to certify a person as eligible for credits based on the economic activity of another person, the following would have to apply: (a) the person's [to be certified] economic activity was instrumental in enabling another person to conduct economic activity in the development opportunity zone; (b) Commerce determined that the economic activity of the other person would not occur without the involvement of the person to be certified; (c) the person to be certified for tax benefits would pass the tax benefits through to the other person conducting economic activity in the development opportunity zone; and (d) the other person conducting economic activity in the zone would not claim tax benefits.

A person that intended to claim tax benefits based on the economic activity of another would be required to submit an application to Commerce, in the form prescribed by the Department, with information required by Commerce and by DOR. Commerce would be required to verify information submitted for tax credits and to notify DOR of all persons that were certified to claim

tax credits.

Commerce would be required to revoke the certification for tax credits under this provision if it determined that the person: (a) supplied false or misleading information; (b) ceased operations in the development opportunity zone; or (c) did not pass tax benefits through to the other person conducting economic activity in the zone, as determined by Commerce. The Department would be required to notify DOR within 30 days of the revocation.

8. As noted, Commerce currently administers the development and enterprise development zone programs that provide tax credits to businesses that locate in the zones. Under the development zones program, Commerce designates an area within one or more city, village, town or Native American reservation as a zone. In order to be designated, the areas are subject to maximum property value and population limits. Areas comprised of entire counties may be designated a development zone if the population of the area is 75,000 or less. Designation as a development zone is effective for 20 years. The local governing body can apply to Commerce for one five-year extension of the designation. Commerce has designated 20 of the 22 authorized development zones. The designated zones are located in: Beloit; Eau Claire; Fond du Lac; Green Bay; Janesville; Manitowoc; Milwaukee; Racine; Richland Center; Sturgeon Bay; Superior; Two Rivers; Ashland, Bayfield and Price Counties; Iron County; Florence, Forest, Lincoln and Langlade Counties (North Four); Juneau, Adams and Marquette Counties; Grant and LaFayette Counties; Marinette and Oconto Counties; and the Lac du Flambeau and Stockbridge-Munsee Indian Reservations. Commerce allocates the total statewide authorization of development zones credits ($38.155 million) to each of the 22 development zones. Businesses which conduct economic activity in the zones can claim the development zone jobs and environmental remediation credit. Commerce has allocated $27.3 million in tax credits to the 20 designated zones. Individual businesses have been allocated $26.7 million of those credits.

9. The 1995-97 budget created the enterprise development zone program. A business that conducts or that intends to conduct economic activity in an area of the state can apply to Commerce to have the area designated as an enterprise development zone by submitting an application and a project plan. The Department can designate the area as an enterprise development zone if the area meets certain criteria and the Department approves the project plan. Commerce is authorized to establish the length of time an enterprise development zone can be designated, but the zone cannot be designated for more than seven years (84 months). The total number of enterprise development zones that can be created is 79. Ten of these zones are required to be for environmental remediation projects. Employers in the zones do not have to claim jobs credits. A business which conducts economic activity in an enterprise development zone and is certified by Commerce can claim the development zones tax credits. Only one person is eligible for tax benefits in an enterprise development zone. The maximum amount of credits that can be claimed by an eligible business in an enterprise development zone is established by Commerce, but cannot exceed $3 million. A total of 40 enterprise development zones have been certified in 41 municipalities. A total of $67.8 million in tax credits have been allocated to businesses in enterprise development zones.

10. In order for Commerce to designate an area as a development or enterprise development zone it must meet certain criteria that measure economic distress. Specifically, to be designated as a development or enterprise development zone at least three of the following criteria must apply: (a) the unemployment rate in the area is higher than the state average for the 18 months immediately preceding the date on which the application for creating the zone was filed; (b) the percentage of persons residing in the area who are members of households with household income levels at or below 80% of the statewide median household income is higher than the state average; (c) the percentage of households in the area receiving unemployment compensation or participating in the Wisconsin Works program is higher than the state average; (d) in the 36 months immediately preceding the date on which a application for creating a zone was submitted to the Department of Commerce, a number of workers in the area were permanently laid off by their employer or became unemployed as a result of a business action subject to the state business closing law; (e) an employer in the vicinity of the area has given public notice under state law of either a business closing or reduction of the greater of 25 employees or 25% of the employees of a business that will result in a number of workers being laid off permanently; (f) property values in the area have been declining; or (g) there has been a decline in population in the area.

11. Since 1994, four development opportunity zones have been created in the state. Under the provisions of 1993 Wisconsin Act 232, an area in the City of Beloit and an area in the City of West Allis were designated as development opportunity zones. The West Allis zone was created to make Quad/Graphics eligible for tax credits for a business expansion in the zone and $3.0 million in tax credits was authorized for the zone. The Beloit zone was created as an incentive to attract Motorola to locate in Wisconsin and $10.0 million in tax credits was allocated to the zone. However, Motorola expanded in Illinois and the Reynolds Wheels company located in the Beloit zone. A total of $2.8 million in tax credits was allocated to the zone. Under the provisions of 1995 Act 2, an area in the City of Eau Claire was designated a development opportunity zone for Hutchinson Technology, Inc. and $3.0 million in tax credits was reallocated from the Beloit zone. The businesses in these zones could claim development zones credits. Prior to 1997 Wisconsin Act 27 (the 1997-99 biennial budget), businesses could claim any of seven development zone tax credits including a jobs credit, investment credit, location credit, sales tax credit, research credit, day care credit and environmental remediation credit. The jobs and sales tax credits were refundable.

12. The 1999-01 biennial budget (1999 Wisconsin Act 9) designated an area in the City of Kenosha as a development opportunity zone that exists for seven years. A business that conducts economic activity in the zone is eligible to claim the development zone jobs and environmental remediation tax credit and the former development zone investment credit. The credit equals 2.5% of the purchase price of depreciable tangible personal property or 1.75% of the price of depreciable tangible personal property that is expensed under section 179 of the federal internal Revenue Code. DaimlerChrysler AG is planning a $600 million expansion of its Kenosha engine plant in the zone, and the tax credits are part of a package of state and federal aid to help finance the cost of the expansion. The expansion will be used to start a new engine line at the plant.

13. The Milwaukee development opportunity zone would provide financial assistance for a $32 million renovation of the Boston Store building at the Grand Avenue Mall in downtown

Milwaukee. Wisconsin Energy Corporation purchased the building from Boston Store last year, has leased the building back to Boston Store and is funding the renovations. The remodeled building would have a smaller Boston Store, renovated corporate offices for Carson Pirie Scott (a division of Saks Inc., that runs Boston Store), and 60 apartments. State financial assistance for the renovation project will be provided by $4.7 million in development opportunity zone tax credits, a $1.0 million forgivable loan from the Wisconsin Development Fund and a $250,000 brownfields grant.

14. State financial assistance for the Boston Store renovation project is supported because it would preserve Boston Store as an anchor for the Grand Avenue Mall, retain 200 current Boston Store jobs for at least 10 years, and retain Carson Pirie Scott's corporate headquarters and 650 jobs for at least 15 years. Economic activity at the Grand Avenue Mall would increase. The remodeling project has also generated construction jobs. Finally, the historic character of a landmark building would be significantly improved.

15. Some have criticized the proposed Milwaukee development opportunity zone because it would provide a direct government subsidy to a private business. Although the development and enterprise development zones programs also benefit businesses, the zones must be located in areas that meet certain economic distress criteria. In addition, many of the jobs retained by the renovation project are in the retail business, whereas most development and enterprise development zones allocate tax credits to manufacturing businesses where jobs are generally higher paying. Of the 40 enterprise development zones currently designated, about 90% were created for manufacturers. Finally, providing financial assistance to the Boston Store renovation could lead to requests for similar assistance for other businesses in the state. A recent economic study of economic development incentives in the Detroit metropolitan area found that the likelihood of communities offering tax incentives just because other communities in the metropolitan area were offering them increased over time (Anderson and Wassmer, 2000).

16. Since renovation has already begun on the building, a question arises as to whether or not the financial assistance provided through the development opportunity zone tax credits would be necessary for the project to be undertaken. Note that the credits could be claimed based on investment that occurred before the area is designated as a zone if the completed project is placed in service after designation. Presumably, the project was initiated in anticipation of legislative approval of the proposed zone. Economic research on the effectiveness of tax incentives on economic development has provided data to support the positions of both proponents and opponents of the use of tax incentives as an economic development strategy. State governments have an appropriate interest in the creation of local incentive programs if such incentives are effective at retaining and directing economic activity to places where there is a public benefit to the state arising from the creation or retention of jobs in that area. Studies have identified a public benefit when jobs are created in persistently high unemployment, economically declining areas and fiscal benefits have been identified when job creation puts existing but underutilized public infrastructure and services to use (Bartik, 1994). Studies of the Indiana enterprise zone program found that the value of inventories increased while the value of manufacturing and equipment decreased, indicating a shift in the type of capital investment. In addition, unemployment claims in the zones dropped significantly (Papke, 1994, 2001). On the other hand, research on the sensitivity of investment to tax

differentials indicates that such differences do not induce substantial investment (Wasylenko, 1997). Other studies have indicated that the benefits of tax incentives are generally less than their costs to governments (Fisher and Peters, 2001, Anderson and Wassmer, 2000). A study on enterprise zones (Fisher and Peters, 2001) concludes that there will be net revenue gains only if the zone incentives succeed in attracting sufficient jobs from outside the state. To the extent that there are additional effects in the form of a redirection of investment into zones from elsewhere within the state, there will be a redistribution of economic activity that will favor zone cities, which may be considered desirable.

17. Although up to $4.7 million in tax credits could be claimed for investment, remediation and jobs created or retained, the bill does not include a fiscal effect for creating the Milwaukee development opportunity zone and providing the tax credits. As noted, Wisconsin Electric Corporation owns the building and is conducting the renovation. Since renovation has already begun, the development zone capital investment credit could be claimed based on the purchase of the building and the construction and remodeling costs. In addition, the provision allowing credits to be claimed based on the economic activity of another would allow Wisconsin Electric to claim the jobs credit based on jobs retained or created by Boston Store and Carson Pirie Scott, as long as the benefits are passed on to those businesses. The tax credits would be available for tax year 2001 if the bill is effective before July 31; however, if the bill is effective after that date the tax credits could not be claimed until tax year 2002. Corporate taxpayers' final returns are due on the fifteenth day of the third month after the end of their fiscal year but corporations can also take an automatic six-month extension. If the bill is not effective before July 31, the first year for which tax credits could be claimed would be 2002. If the automatic extension of the filing date for corporate returns was used, the credits would not be claimed until September 2003. As a result, unless the bill is effective before July 31, it is not likely that the tax credits would be claimed by Wisconsin Electric Corporation during the 2001-03 biennium.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to designate an area in the City of Milwaukee as a development opportunity zone that would exist for seven years, beginning with the effective date of the bill. Authorize any corporation that conducts economic activity in the zone and that, in conjunction with the Common Council of the City of Milwaukee, submits a project plan to claim the development zone tax credit, the development zone investment credit and a development zone capital investment credit that would be created in the bill. Limit the maximum amount of tax credits that could be claimed by businesses in the zone to $4.7 million.

2. Maintain current law.

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