

*STATE OF WISCONSIN**REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**2003 ASSEMBLY BILL 807*

[Introduced by Representatives Musser, Kreibich, Nischke, Pettis, Suder, Owens, Boyle, J. Wood, Turner, Krawczyk, Gunderson, McCormick, Hahn, Nass and Albers; cosponsored by Senator Kanavas.]

**General Nature of Proposal**

The bill adopts, for state income and franchise tax purposes, amendments made to the federal Internal Revenue Code contained in the federal Military Family Tax Relief Act of 2003, which was adopted by Congress via Public Law 108-121. The specific changes made by the bill through the adoption of the federal act are described in the "Fiscal Effect" portion of this Report.

In addition, under current law, income received from the federal government by armed forces and reserve component members serving in a combat zone is excluded from income for federal and state income tax purposes. The bill would extend the state income tax exemption to the pay (basic, special, and incentive) of a reserve component member (Reserves and National Guard) called to federal active service in a combat zone or for a peace-keeping mission. In addition, the bill makes the tax exemption available to a member of the reserve component who is called to special state service as defined under federal law. This is state service authorized by the U.S. Department of Defense in which the Governor may call up members of the National Guard for purposes such as airport security duty and other homeland security assignments. The exemption would not include training wages.

**Legality Involved**

There are no questions of legality involved.

**Fiscal Effect Upon the State and Its Subdivisions**

The Department of Revenue explains the fiscal effect of the bill as follows:

This bill adopts, for state income and franchise tax purposes, changes to the Internal Revenue Code made by Public Law 108-121, the Military Family Tax Relief Act of 2003 (MFTRA).

MFTRA provides tax relief for members of the military serving in the Middle East and their families that will affect the tax returns filed for 2003. Wisconsin taxpayers who claim the tax relief on their 2003 federal returns would need to make adjustments on their state returns to recognize differences between state and federal law until Wisconsin adopts these provisions in 2004, at which time these taxpayers would need to file amended returns for 2003 to claim this tax relief for Wisconsin purposes.

This bill would reduce state income tax revenues for tax year 2003 by \$500,000 in FY 04, due to a deduction for travel expenses for National

Guard and Reserve personnel. The loss from other provisions would be minimal. The provisions of MFTRA that would be adopted for state tax purposes under this bill include the following:

- The military death benefit is doubled from \$6,000 to \$12,000 and the full amount of the benefit is excluded from income; previously, one-half of the benefit was taxable. These changes are retroactive to September 11, 2001, and thus apply to military operations in Afghanistan and Iraq, as well as other locations since that date.
- The act clarifies that dependent care assistance provided by the U.S. Department of Defense is a qualified military benefit that is excluded from a taxpayer's gross income. The exclusion is effective for tax years beginning after December 31, 2002.
- The act eases a restriction on the exclusion for the gain from the sale of a residence for uniformed and foreign service personnel. Under current law, taxpayers may exclude up to \$250,000 (\$500,000 for married couples filing jointly) of gain from the sale of a principal residence if they owned and used the property as a principal residence for two or more years during the five years preceding the sale. Uniformed and foreign service personnel called to active duty away from home may elect to suspend the five-year test, for one property, for up to five years. If the election is made, the five-year period does not include any period, up to five years, during which the service member is on extended duty (more than 90 days) at least 50 miles from home or in government quarters under government orders. The provision is retroactive to sales made after May 6, 1997.
- An exclusion from income is provided for reimbursement paid to members of the military for losses on the sale of their homes resulting from declines in home values due to a military base closure or reduction in operations. The exclusion, effective on November 12, 2003, is limited to the fair market value of the property.
- MFTRA provides a deduction from gross income for travel expenses for members of the National Guard and Reserve when they travel more than 100 miles away from home and must stay away overnight. Under previous law, the deduction was from adjusted gross income, and thus limited to persons itemizing their deductions. The deduction applies to expenses paid or incurred for tax years starting after December 31, 2002.
- MFTRA expands the income and estate tax relief provided under the Victims of Terrorism Act of 2001 to astronauts who die in the line of duty, effective for deaths occurring after December 31, 2002. These

provisions benefit the families of the astronauts killed in the space shuttle Columbia accident.

- MFTRA also allows the filing extension provided to military personnel serving in a combat zone under current law to troops deployed in contingency operations, that is, those who may become involved in military actions. Wisconsin automatically adopts federal filing extensions under current law.
- Other provisions of the act do not have a substantive effect on Wisconsin.

The subtraction from FAGI for payments to members of a reserve unit while on active duty would first apply to taxable years beginning on January 1 of the year in which the subsection takes effect, or on January 1 of the following year if this subsection takes effect after July 31.

According to the Wisconsin National Guard website, there are 1,460 Wisconsin National Guard members and 1,590 Wisconsin reservists currently mobilized. According to the Defense Manpower Data Center, 6.7% of active duty personnel are officers, the average annual pay of enlisted and officers is \$22,624 and \$52,943, respectively. Enlisted personnel and officers are on active duty for an average of 156 days and 130 days, respectively. All 12,900 Wisconsin National Guard members and reservists are required to complete a two-week annual training period during which time they receive military pay and are considered to be on active duty.

Income received by reservists who are on active duty and serving in a combat zone is excluded from income for federal and state tax purposes. Therefore, this bill would apply to active reservists who do not serve in a combat zone. There are about 1,000 Wisconsin national guardsmen currently on active duty and serving in a combat zone. However, the number of Wisconsin reservists mobilized to serve in a combat zone is unknown.

Assuming about 2,050 Wisconsin military personnel are on active duty and not serving in a combat zone at any given point throughout the year, other than during the two-week training period, annual military pay to Wisconsin active duty personnel totals \$20.9 million. The payroll for the annual training period totals \$13.1 million. Assuming an average marginal tax rate of 5.5%, exempting this pay from taxation would decrease state income tax revenues by \$1.9 million (\$34.0 million x .055). However, this fiscal effect may be overstated in that some of these active duty personnel are serving in a combat zone and therefore by law already receive an exclusion from taxation of military pay.

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The total annual revenue loss due to the adoption of certain tax provisions in the MFTRA and the creation of a subtraction for active duty military personnel would be \$2.4 million (\$1.9 million + \$0.5 million).

**Public Policy Involved**

The bill is good public policy if it is amended to provide that a person who claims the active duty deduction under the bill may not also claim the Armed Forces Tax Credit under s. 71.07 (6m), Stats.

3/03/04

**JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**