Wisconsin Department of Administration
Division of Executive Budget and Finance

Fiscal Estimate - 2011 Session

☒ Original ☐ Updated ☐ Corrected ☐ Supplemental

LRB Number **11-3206/2**	Introduction Number **AB-0637**

Description
Disregarding a taxpayer's election to include another in its combined group, disallowing certain carry-forward amounts for combined reporting purposes, repealing the income and franchise tax credit for qualified production activities income, repealing the changes made to the earned income tax credit in 2011 Wisconsin Act 32, restoring indexing provisions to the homestead tax credit, eliminating the individual income tax exclusion for long-term capital gains other than for farm assets, computing the estate tax based on 2002 federal law, and creating a new individual income tax upper bracket

Fiscal Effect

State:
☐ No State Fiscal Effect
☐ Indeterminate
☒ Increase Existing Appropriations
☐ Decrease Existing Appropriations
☐ Create New Appropriations
☒ Increase Existing Revenues
☐ Decrease Existing Revenues
☒ Increase Costs - May be possible to absorb within agency's budget ☒ Yes ☐ No
☐ Decrease Costs

Local:
☒ No Local Government Costs
☐ Indeterminate
1. ☐ Increase Costs ☐ Permissive ☐ Mandatory
2. ☐ Decrease Costs ☐ Permissive ☐ Mandatory
3. ☐ Increase Revenue ☐ Permissive ☐ Mandatory
4. ☐ Decrease Revenue ☐ Permissive ☐ Mandatory
5. Types of Local Government Units Affected
☐ Towns ☐ Village ☐ Cities
☐ Counties ☐ Others
☐ School Districts ☐ WTCS Districts

Fund Sources Affected
☒ GPR ☐ FED ☐ PRO ☐ PRS ☐ SEG ☐ SEGS

Affected Ch. 20 Appropriations
20.835(2)(c); 20.835(2)(f)

Agency/Prepared By	Authorized Signature	Date
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Fiscal Estimate Narratives
DOR 1/12/2012

LRB Number **11-3206/2**	Introduction Number **AB-0637**	Estimate Type **Original**
Description Disregarding a taxpayer's election to include another in its combined group, disallowing certain carry-forward amounts for combined reporting purposes, repealing the income and franchise tax credit for qualified production activities income, repealing the changes made to the earned income tax credit in 2011 Wisconsin Act 32, restoring indexing provisions to the homestead tax credit, eliminating the individual income tax exclusion for long-term capital gains other than for farm assets, computing the estate tax based on 2002 federal law, and creating a new individual income tax upper bracket		

Assumptions Used in Arriving at Fiscal Estimate

The bill makes a number of changes to tax law, as described below:

CONTROLLED GROUP ELECTION
Under current law, a taxpayer may elect to include in its combined group every corporation in its commonly controlled group, regardless of whether such corporations are engaged in the same unitary business of the taxpayer. Under current law, the Department of Revenue (DOR) may not disallow such an election, or disregard its tax effect. Under this bill, if DOR determines that such an election has the effect of tax avoidance, DOR must disregard the election's tax effect or disallow the election.

SHARING PRE-2009 NET BUSINESS LOSS CARRYFORWARDS
Under current law, for each taxable year that a corporation that is a member of a combined group has net business loss carry–forward from a taxable year beginning before January 1, 2009, the corporation may, for 20 taxable years, use up to 5 percent of the net business loss carry–forward to offset the income of all other members of the combined group. The bill eliminates this provision.

QUALIFIED PRODUCTION ACTIVITIES INCOME CREDIT
Under current law, an individual taxpayer may claim a state income tax credit equal to the taxpayer's qualified production activities income derived from manufacturing property and agricultural property, multiplied by a certain percentage. A corporation or insurer may claim a state income and franchise tax credit equal to the lesser of its taxable income apportioned to this state or its qualified production activities income derived from manufacturing property or agricultural property located in this state, multiplied by a certain percentage. The percentage of qualified production activities income that a taxpayer may claim as a credit is 1.875 percent for 2013, 3.75 percent for 2014, 5.526 percent for 2015, and 7.5 percent for 2016 and for each year thereafter. The bill eliminates the credit.

ESTATE TAX
Wisconsin's estate tax, under current law, is equal to the credit allowed for state estate taxes paid under federal law. Since current federal law does not provide such a credit for deaths in 2011 and 2012 (but, instead, allows a deduction for state estate taxes paid), Wisconsin's estate tax is effectively dormant. In addition, Wisconsin's estate tax will remain dormant if the current federal deduction, rather than credit, for state estate taxes paid is extended for deaths in 2013 and beyond. If, however, no further federal legislation pertaining to estate tax is enacted, current federal law will expire and Wisconsin's tax would be reactivated since the federal credit for state estate taxes paid would be restored.

For deaths that occurred from October 1, 2002 to January 1, 2008, Wisconsin's estate tax was linked to the federal credit for state estate taxes in effect under federal law as of December 31, 2000. This link to federal law as of that point in time maintained a Wisconsin estate tax for deaths during this period despite a phase-out of the federal credit for state estate taxes paid during this period.

Under the bill, for deaths occurring after December 31, 2011, the Wisconsin estate tax is equal to the federal estate tax credit allowed for state death taxes as computed under the federal estate tax law in effect on December 31, 2002. Furthermore, the bill excludes property used in farming from Wisconsin's estate tax. The tie to federal tax law as of December 31, 2002 excludes estates under $1 million from taxation and links Wisconsin to the first year of the federal phase-out of the state estate tax credit - wherein the federal credit for state death taxes was reduced by 25%.

EARNED INCOME TAX CREDIT

Under current law, as created in 2011 Wisconsin Act 32, the earned income tax credit (EITC) is reduced for claimants with two or more qualifying children. This bill repeals those provisions and restores former law. Under the bill, the EITC, as a percentage of the federal credit, would be 4 percent for claimants with one qualifying child, 14 percent for claimants with two qualifying children, and 43 percent for claimants with three or more qualifying children.

HOMESTEAD TAX CREDIT

Under current law, low-income homeowners and renters may qualify for a refundable homestead tax credit based on household income and property taxes or rent constituting property taxes. The maximum credit is $1,168 for claimants with household income of no more than $8,060 and property taxes of at least $1,460. The credit amount phases out at income levels above $8,060 and no credit is allowed for persons with household income above $24,680.

Under this bill, the homestead credit formula factors are indexed for inflation in 2011 and thereafter using the procedure that existed prior to 2011 Wisconsin Act 32.

EXCLUSION FOR LONG-TERM CAPITAL GAINS

Under current law, there is an income tax exclusion for individuals, fiduciaries, members of limited liability companies and partnerships, and shareholders of tax–option corporations for 30 percent of the net long–term capital gains realized from the sale of assets held more than one year and the sale of all assets acquired from a decedent, and an exclusion for 60 percent of such gains realized from the sale of farm assets held more than one year and the sale of all farm assets acquired from a decedent. Under this bill, the exclusion of 30 percent of such net long–term capital gains, and all assets acquired from a decedent, does not apply to taxable years beginning after December 31, 2011.

INDIVIDUAL INCOME TAX UPPER BRACKET

Under current law, there are five income tax brackets for single individuals, certain fiduciaries, heads of households, and married persons. The brackets are indexed for inflation. The rate of taxation under current law for the lowest bracket is 4.6 percent of taxable income; the rate for the second bracket is 6.15 percent; the rate for the third bracket is 6.5 percent; the rate for the fourth bracket is 6.75 percent; and the rate for the highest bracket is 7.75 percent.

For tax year 2012, the highest bracket will apply to taxable income exceeding $232,660 for single individuals, certain fiduciaries, and heads of households. For married persons, the highest current bracket will apply to taxable income exceeding $310,210 for joint filers and $155,110 for separate filers.

This bill creates a sixth bracket with a tax rate of 8.75 percent beginning for tax year 2012. For single individuals, certain fiduciaries, and heads of households, this bracket applies to taxable income exceeding $1,000,000. For married persons, this bracket applies to taxable income exceeding $1,000,000 for joint filers and $500,000 for separate filers. This bracket is indexed for inflation.

FISCAL ESTIMATES

TOTAL FISCAL ESTIMATE

As described below, the provisions of the bill would result in an increase in revenue of an estimated $104.9 million in FY 2012, $344.4 million in FY 2013, and $425.8 million in FY 2014. In addition, the bill would result in an increase in expenditures of an estimated $28.2 million in FY 2012, $35.7 million in FY 2013, and $43.1 million in FY 2014.

CONTROLLED GROUP ELECTION

Data do not exist to estimate this provision. It is unknown whether any controlled group elections would be determined to be solely for the purpose of tax avoidance or what the net tax effect of disallowing that election would be. If such a determination is made and a controlled group election is disallowed, it is assumed that it would result in an increase in revenue of an unknown amount.

SHARING PRE-2009 NET BUSINESS LOSS CARRYFORWARDS

Based on a simulation using tax year 2007 corporate returns, and adjusting for changes in the economy since 2007, disallowing the sharing of pre-2009 net operating loss carryforwards would result in an increase in revenue of an estimated $9.2 million in FY 2012, $37.2 million in FY 2013, and $39.1 million in FY 2014. These estimates assume the bill is effective before June 15, 2012 which is the due date for the 2nd quarter 2012 corporate estimated payment for most corporations. If the bill is effective after June 15, 2012, the fiscal effect shown for FY 2012 would be shifted into FY 2013.

QUALIFIED PRODUCTION ACTIVITIES INCOME CREDIT
Repeal of the qualified production activities income credit would result in an increase in corporate income and franchise tax revenue of $10.5 million in FY 2013, $42.1 million in FY 2015, $81.1 million in FY 2015, $122.2 million in FY 2016, and $154.8 million in FY 2017.

ESTATE TAX
From FY05 to FY07, Wisconsin's estate tax collections averaged approximately $114 million per year. Since these collections occurred during Wisconsin's link to federal tax law in effect as of Dec. 31, 2000, these collections occurred in a period that excluded $675,000 from taxation. Adjusting this average for the change in U.S. household net worth from this period to 2012 (+1.4%), the increase in the exclusion from $675,000 to $ 1 million (-$8.8 million), and the 25% phase-out of the credit, reduces the anticipated annualized revenue increase under the bill for death in 2012 to $80.1 million prior to the farm exclusion. Based on nationwide data compiled by the IRS for 2008, farm assets accounted for 2.4% of assets reported on federal estate tax returns. Assuming this percentage would apply to Wisconsin taxable estates under the bill, the estimated increase in revenue under the bill pertaining to deaths in 2012 is estimated to be $78.2 million.

While the bill will increase Wisconsin estate tax collections for deaths occurring in 2012, collections pertaining to deaths in 2013 and beyond may be higher or lower than what would occur under current law depending on future federal legislation. If, however, future federal action maintains the existing deduction rather than credit for state estate taxes (as occurred under the most recent federal legislation enacted), Wisconsin's current law tax will remain dormant, and the bill will continue to increase revenues compared to current law. The fiscal effect by state fiscal year will be dependent on the effective date of the bill. Estate tax returns are generally due nine months after the death of the decedent.

Assuming Wisconsin's current tax remains dormant, and given that estate tax returns are generally due nine months after the death of the decedent, the bill is expected have minimal impact on FY12 collections, increase FY13 GPR tax collections by $58.7 million, and increase FY14 GPR tax collections by $78.2 million.

EARNED INCOME TAX CREDIT
It is estimated that increasing state EITC rates will increase the credit amount by $24.9 million in FY 2012, $26.5 million in FY 2013, and $27.7 million in FY 2014, and similar amounts annually thereafter.

HOMESTEAD TAX CREDIT
Based on a simulation using the 2010 homestead credit claims, the bill is expected to increase the credit amount by $3.3 million in fiscal year 2012, $9.2 million in fiscal year 2013, $15.4 million in fiscal year 2014, and increasing amounts annually thereafter.

Since the 2011 homestead credit forms and instructions have already been finalized and sent to the printer, this bill would require reprinting those forms and instructions. As such, the department of revenue anticipates a one-time administrative cost of $32,000 associated with this bill.

EXCLUSION FOR LONG-TERM CAPITAL GAINS
Based on simulations using the 2008 individual income tax model, adjusted for income and inflation, the bill is expected to increase revenue by $52.1 million in fiscal year 2012, $134 million in fiscal year 2013, and $152 million in fiscal year 2014 and similar amounts annually thereafter.

INDIVIDUAL INCOME TAX UPPER BRACKET
Based on simulations using the 2008 individual income tax model, adjusted for income and inflation, the bill is expected to increase revenue by $40.2 million in fiscal year 2012, $94.9 million in fiscal year 2013, and $104 million in fiscal year 2014 and similar amounts annually thereafter.

Many individuals who would be impacted by the new upper bracket, would also be impacted by the elimination of the capitals gains exclusion. There is an additional fiscal effect associated with enacting both of these provisions that would not occur if only the new bracket or the elimination of the capital gains exclusion was proposed. Based on simulations using the 2008 individual income tax model, adjusted for income and inflation, this interaction between increased taxable income and an increased tax rate would raise revenue by an additional $3.4 million in fiscal year 2012, $9.1 million in fiscal year 2013, and $10.4 million in fiscal year 2014 and similar amounts annually thereafter.

Long-Range Fiscal Implications

	FY 2012		FY 2013		FY 2014	
Provision	**Revenue**	**Expense**	**Revenue**	**Expense**	**Revenue**	**Expense**
Controlled Group	unkown		unkown		unkown	
Sharing Losses	9,200,000		37,200,000		39,100,000	
QPAI Credit			10,500,000		42,100,000	
EITC		24,900,000		26,500,000		27,700,000
Homestead		3,300,000		9,200,000		15,400,000
Cap Gains	52,100,000		134,000,000		152,000,000	
New Bracket	40,200,000		94,900,000		104,000,000	
Interaction Effect	3,400,000		9,100,000		10,400,000	
Estate Tax	minimal		58,700,000		78,200,000	
Totals	104,900,000	28,200,000	344,400,000	35,700,000	425,800,000	43,100,000

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Fiscal Estimate Worksheet - 2011 Session

Detailed Estimate of Annual Fiscal Effect

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I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):

II. Annualized Costs:	**Annualized Fiscal Impact on funds from:**	
	Increased Costs	Decreased Costs
A. State Costs by Category		
State Operations - Salaries and Fringes	$	$
(FTE Position Changes)		
State Operations - Other Costs		
Local Assistance		
Aids to Individuals or Organizations	43,100,000	
TOTAL State Costs by Category	**$43,100,000**	**$**
B. State Costs by Source of Funds		
GPR	43,100,000	
FED		
PRO/PRS		
SEG/SEG-S		

III. State Revenues - Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, ets.)		
	Increased Rev	Decreased Rev
GPR Taxes	$425,800,000	$
GPR Earned		
FED		
PRO/PRS		
SEG/SEG-S		
TOTAL State Revenues	**$425,800,000**	**$**

NET ANNUALIZED FISCAL IMPACT		
	State	Local
NET CHANGE IN COSTS	$43,100,000	$
NET CHANGE IN REVENUE	$425,800,000	$

Agency/Prepared By	**Authorized Signature**	**Date**
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