LRBb0664

1999 DRAFTING REQUEST

Assembly Amendment (AA-AB133)

Received: **06/11/99**

Received By: **shoveme**

Wanted: **As time permits**

Identical to LRB:

For: **Legislative Fiscal Bureau 7-7417**

By/Representing: **Doty**

This file may be shown to any legislator: **NO**

Drafter: **shoveme**

May Contact:

Alt. Drafters:

Subject: **Tax - individual income**

Extra Copies:

Pre Topic:

LFB:......Doty -

Topic:

Maintain current tax law treatment of social security

Instructions:

See Attached. LFB Paper # 100, altertative 2

Drafting History:

Vers.	Drafted	Reviewed	Typed	Proofed	Submitted	Jacketed	Required
/1	shoveme 06/11/99	chanaman 06/11/99	mclark 06/11/99	_______ _______	lrb_docadmin 06/12/99		

FE Sent For:

<END>

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/1	shoveme	cmh 6/11	mrc 6/11	MRC/CH ~~6/11~~			

/1 WES 6/11/99 h

FE Sent For:

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Shovers, Marc

From: Doty, Kelsie
Sent: Friday, June 11, 1999 9:45 AM
To: Shovers, Marc
Subject: Income tax drafting request

I have six items that need drafts. ~~Give me a call if you need clarification.~~

1. Paper #100 -- Alt 2. Maintain the current law tax treatment of social security benefits.

2. ~~Paper #101 -- Alt 2. Retain indexing of the income tax brackets. Start indexing the newly created top tax bracket in 2001.~~

3. Add the provisions of Substitute Amendment 1 to SB 49 (filing thresholds).

4. Paper #106 -- Alt 1 (as modified). Approve the Governor's recommendation to eliminate miscellaneous itemized deductions with two changes.

   a. Continue to allow professional dues and union dues to be included as a miscellaneous itemized deduction under the credit.

   b. Create a subtract modification from federal AGI for the amount claimed as a federal miscellaneous itemized deduction for repayment of income that was taxed in a prior year. Specify that the amount claimed under the claim of right credit can not be claimed under the subtraction.

5. Paper #108 -- Alt 1. Modify the current indexing provisions to incorporate the federal indexing method into state law. Specifically, eliminate the maximum income amounts for the standard deduction from the statutes and specify that the tax brackets and standard deduction be indexed based on the 1998 amounts.

6. Motion #1407. Modify current law as it relates to the taxation of inter vivos trusts. I'll fax over a copy of the motion and the language that the lobbyist attempted to draft.

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June 7, 1999 Joint Committee on Finance Paper #100

Individual Income Tax Modifications: Taxation of Social Security Benefits (General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 1999-01 Budget Summary: Page 20, #1]

CURRENT LAW

Wisconsin currently follows pre-1994 federal law and taxes up to 50% of social security benefits for taxpayers with provisional income above the following thresholds: $25,000 if single, $32,000 if married-joint and zero if married-separate. The taxable portion is the lesser of: (a) one-half of net social security benefits; or (b) one-half of the amount by which provisional income exceeds the threshold amount. Provisional income is defined as one-half of social security plus federal adjusted gross income (AGI), tax-exempt interest and other specified amounts that are excluded from gross income. No benefits are taxed for taxpayers with provisional income below these threshold amounts.

The federal taxation of social security was modified under the Revenue Reconciliation Act of 1993, which increased the amount of taxable social security benefits from 50% to 85% for taxpayers with income above a higher threshold level beginning in 1994. The pre-1994 law still applies to taxpayers with income below $34,000 if single and $44,000 if married filing a joint return. However, the taxable portion of social security for taxpayers with provisional income above these thresholds is the lesser of: (a) 85% of social security; or (b) the amount included under the 1993 law (not to exceed $4,500 if single and $6,000 if married-joint) plus 85% of the excess of provisional income over the income thresholds. Married taxpayers who file separate returns pay taxes on up to 85% of social security benefits.

The following table summarizes the taxation of social security under current state law and under federal law for single and married-joint taxpayers, based on income.

Provisional Income	Taxable Portion Under Current State Law	Taxable Portion Under Federal Law
$0 to $25,000 if Single $0 to $32,000 if Married-Joint	None	None
$25,000 to $34,000 if Single $32,000 to $44,000 if Married-Joint	Up to 50%	Up to 50%
$34,000 and Over if Single $44,000 and Over if Married-Joint	Up to 50%	Up to 85%

GOVERNOR

Federalize the treatment of social security benefits and tax up to 85% of social security for taxpayers with provisional income above $34,000 if single and $44,000 if married-joint and for all married-separate taxpayers. Taxpayers with income below these amounts would not be impacted by the modification.

DISCUSSION POINTS

1. One of the tax policy principles to be considered in structuring an individual income tax is the goal of tax equity, which holds that the tax structure should provide equal treatment of equals and include only reasonable differences in the taxation of unequals. Specifically, the principle of horizontal equity indicates that taxpayers with the same amount of economic income should pay the same amount of tax. Economic income may be adjusted to reflect distinctions for lesser ability to pay taxes, such as unusual medical expenses and casualty losses, or to recognize the higher subsistence costs of taxpayers with large families.

2. It could be argued that both the current state and federal tax treatments of social security benefits violate the principle of horizontal equity because taxpayers with social security income do not pay taxes on all of their income, while a taxpayer with the same total income that is comprised entirely of wages does not receive a similar exclusion. On the other hand, the complete exclusion for social security that is provided to lower-income taxpayers and the partial exclusion provided to upper-income taxpayers could be considered an adjustment to reflect a lesser ability to pay that is typically associated with social security recipients who may have relatively high medical expenses and fixed incomes.

3. A rationale for the current state tax treatment of social security for higher-income taxpayers is that one-half of a worker's combined payroll tax is paid by the employer from before-tax income. The other half is paid by the employe from after-tax earnings. Therefore, higher-income taxpayers are currently taxed on the social security payments attributable to the employer's before-

tax contributions. On the other hand, since retirees generally receive more in benefits than they contributed into the system, it could be argued that increasing the share of taxable social security for retirees with higher income would not impose an undue burden. The rationale used at the federal level when increasing the taxable share to 85% was that the 15% nontaxable share was roughly comparable to the portion of other pension benefits that were not subject to taxation (the portion attributable to after-tax contributions), as estimated at that time by the Congressional Budget Office.

4. Of the 43 states, plus the District of Columbia, that imposed an individual income tax in 1997, 29 exempted all social security benefits from taxation. Fifteen states taxed a portion of social security benefits as follows: three, including Wisconsin, taxed up to 50% of benefits as under pre-1994 federal law; nine followed current federal practice and taxed up to 85%; and three states provided their own taxation scheme. No state taxed 100% of social security benefits.

5. Exempting all social security benefits from taxation would reduce income tax revenues by an estimated $66.5 million each year from current law. As compared to the bill, this would reduce revenues by $98.2 million on an annualized basis.

6. Since the current state treatment of social security does not conform with federal law, taxpayers with income above the higher threshold amounts ($34,000 if single, $44,000 if married-joint and zero if married-separate) are required to complete a separate state worksheet to calculate the difference. The federal worksheet that must be used by most taxfilers with social security income for the 1998 tax year contains 18 steps. The state's social security benefits worksheet requires six steps to be completed to calculate the amount of benefits to be subtracted from federal AGI to determine Wisconsin AGI. Federalizing the treatment of social security would simplify the state tax form for affected taxfilers and the Department.

7. According to data from the Social Security Administration, a total of $7,534 million in social security benefits was paid to Wisconsin residents in 1997. The 1997 Wisconsin tax sample shows that 155,000 Wisconsin residents paid federal taxes on $1,121 million in benefits. For state tax purposes, 95,000 taxpayers subtracted $365.4 million from the federally taxable amount. State taxes were paid on $756 million in benefits.

8. Federalizing the calculation of taxable social security benefits may result in high marginal tax rates on other sources of income for affected taxpayers. For example, under current law, a married couple with $16,000 of social security benefits is not required to include any of these benefits in taxable income if other sources of provisional income are $24,000 or less. Once other sources of provisional income equal $24,000 for these taxpayers (total provisional income equals $32,000), the amount of taxable social security is phased up until it reaches $8,000 when other provisional income is $40,000 or more (the phase-in range is based on the amount of social security benefits and other provisional income and therefore is different for each taxpayer). In this phase-in range, each additional dollar of income from other sources is taxed as if it were $1.50. This effect would be enhanced under the bill because, in the new phase-in range, each additional dollar of income would be taxed as if it were $1.85. It is argued that these provisions create a disincentive for social security recipients to work and penalize individuals who saved for retirement.

9. In addition to federalizing the treatment of social security benefits, the Governor recommends a number of other modifications to the state's individual income tax, including increasing the sliding scale standard deduction, creating personal exemptions, creating a fourth income tax bracket, reducing the income tax rates, eliminating miscellaneous deductions from the itemized deduction credit, increasing the married couple credit, eliminating certain income tax credits and expanding the homestead credit. Many of the tax reduction provisions would offset the effects of the social security provision and even result in a tax decrease for some taxpayers. The other bill provisions are discussed further in separate issue papers prepared by this office.

10. Attachments 1 and 2 to this paper provide distributional information on the Governor's income tax proposal on taxpayers affected by the social security provision for tax years 2000 and 2001, respectively. This information is from the 1997 Wisconsin tax sample, which has data from over 20,000 tax returns, weighted to reflect all taxpayers in 1997. However, changes over time in the number of taxpayers and the kinds and amounts of income, deductions and credits they claim cannot be shown. To the extent possible, changes in tax laws between 1997 and later years have been included.

11. The following table compares all taxpayers with a tax decrease or tax increase under the individual income tax modifications recommended by the Governor to only those who would be impacted by the social security provision. As shown in the table for the 2001 tax year, about 87% of all taxpayers would have a tax decrease under the bill and 13% would have a tax increase. In contrast, only 29.2% of taxpayers affected by the social security provision would have a tax decrease and 70.8% would pay more taxes. Taxpayers affected by the social security provision make up 26.8% of all taxpayers with a tax increase in 2001.

	Count of All Taxpayers Affected by Governor's Proposal	Percent of Total	Count of Taxpayers Affected by Social Security Provision	Percent of Total	Percent of All Taxpayers
Tax Year 2000					
Tax Decrease	1,532,000	80.2%	17,900	19.1%	1.2%
Tax Increase	378,400	19.8	75,800	80.9	20.0
Total	1,910,400	100.0%	93,700	100.0%	4.9%
Tax Year 2001					
Tax Decrease	1,667,000	87.0%	27,400	29.2%	1.6%
Tax Increase	248,300	13.0	66,300	70.8	26.8
Total	1,915,300	100.0%	93,700	100.0%	4.9%

12. Deleting the social security provision from the Governor's budget recommendation and retaining the current law tax treatment of social security would reduce income tax revenues by $32.4 million in tax year 2000 and $32.2 million in tax year 2001 (in 2000 dollars) from the bill. It should be noted that due to the interaction of the various income tax modifications, the fiscal effect of this change would differ if other revisions are made to the Governor's proposal.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to federalize the treatment of social security benefits.

2. Retain the current state income tax treatment of social security benefits. Compared to the bill, this would reduce income tax revenues by $32.4 million in 2000-01 if the other income tax provisions recommended by the Governor are not modified.

Alternative 2	GPR
1999-01 REVENUE (Change to Bill)	- $32,400,000

Prepared by: Kelsie Doty
Attachments

ATTACHMENT 1

Distribution of Taxpayers Affected by the Social Security Provision With a Tax Increase or Decrease Under the Governor's Income Tax Proposal Tax Year 2000

Wisconsin Adjusted Gross Income	Taxpayers With a Tax Decrease: Count	% of Count	Amount of Tax Decrease	Percent of Amount	Average Decrease	Taxpayers With a Tax Increase: Count	Percent of Count	Amount of Tax Increase	Percent of Amount	Average Increase
Under $5,000	0	0.0%	$0	0.0%	$0	0	0.0%	$0	0.0%	$0
5,000 to 10,000	0	0.0%	0	0.0%	0	0	0.0%	0	0.0%	0
10,000 to 15,000	0	0.0%	0	0.0%	0	1,700	2.2%	331,000	1.7%	195
15,000 to 20,000	200	1.1%	-36,000	1.8%	-180	2,000	2.6%	400,000	2.1%	200
20,000 to 25,000	600	3.4%	-44,000	2.2%	-73	2,800	3.7%	616,000	3.2%	220
25,000 to 30,000	800	4.5%	-94,000	4.8%	-118	4,000	5.3%	776,000	4.0%	194
30,000 to 40,000	4,100	22.9%	-426,000	21.7%	-104	9,300	12.3%	2,105,000	10.9%	226
40,000 to 50,000	7,000	39.1%	-895,000	45.6%	-128	12,400	16.4%	2,645,000	13.7%	213
50,000 to 60,000	2,800	15.6%	-266,000	13.6%	-95	14,100	18.7%	3,267,000	16.9%	232
60,000 to 80,000	900	5.0%	-46,000	2.3%	-51	13,400	17.7%	3,872,000	20.0%	289
80,000 to 100,000	300	1.7%	-8,000	0.4%	-27	7,300	9.7%	2,370,000	12.2%	325
100,000 to 200,000	700	3.9%	-47,000	2.4%	-67	6,200	8.2%	1,985,000	10.2%	320
200,000 to 300,000	200	1.1%	-18,000	0.9%	-90	1,200	1.6%	446,000	2.3%	372
300,000 and Over	300	1.7%	-82,000	4.2%	-273	1,200	1.6%	553,000	2.9%	461
TOTALS	17,900	100.0%	-$1,962,000	100.0%	-$110	75,600	100.0%	$19,366,000	100.0%	$256

Wisconsin Adjusted Gross Income	Taxpayers With a Tax Change: Count	Percent of Count	Amount of Tax Change	Percent of Amount	Average Change
Under $5,000	0	0.0%	$0	0.0%	$0
5,000 to 10,000	0	0.0%	0	0.0%	0
10,000 to 15,000	1,700	1.8%	331,000	1.9%	195
15,000 to 20,000	2,200	2.4%	364,000	2.1%	165
20,000 to 25,000	3,400	3.6%	572,000	3.3%	168
25,000 to 30,000	4,800	5.1%	682,000	3.9%	142
30,000 to 40,000	13,400	14.3%	1,679,000	9.6%	125
40,000 to 50,000	19,400	20.7%	1,750,000	10.1%	90
50,000 to 60,000	16,900	18.1%	3,001,000	17.2%	178
60,000 to 80,000	14,300	15.3%	3,826,000	22.0%	268
80,000 to 100,000	7,600	8.1%	2,362,000	13.6%	311
100,000 to 200,000	6,900	7.4%	1,938,000	11.1%	281
200,000 to 300,000	1,400	1.5%	428,000	2.5%	306
300,000 and Over	1,500	1.6%	471,000	2.7%	314
TOTALS	93,500	100.0%	$17,404,000	100.0%	$186

Comments:

This attachment shows the impact of all of the Governor's proposed income tax modifications, except the homestead credit expansion, on only those taxpayers affected by the social security provision in tax year 2000.

According to the 1997 sample, approximately 93,500 taxpayers would be affected by the social security provision under the Governor's proposal.

Of all affected taxpayers with a tax change, 17,900 (19.1%) would have a tax decrease. The average decrease would be $110.

Of all affected taxpayers with a tax change, 75,600 (80.9%) would have a tax increase. The average increase would be $256.

SOURCE: 1997 Wisconsin Tax Sample

ATTACHMENT 2

Distribution of Taxpayers Affected by the Social Security Provision With a Tax Increase or Decrease Under the Governor's Income Tax Proposal Tax Year 2001

Wisconsin Adjusted Gross Income	Taxpayers With a Tax Decrease: Count	% of Count	Amount of Tax Decrease	Percent of Amount	Average Decrease	Taxpayers With a Tax Increase: Count	Percent of Count	Amount of Tax Increase	Percent of Amount	Average Increase
Under $5,000	0	0.0%	$0	0.0%	$0	0	0.0%	$0	0.0%	$0
5,000 to 10,000	0	0.0%	0	0.0%	0	0	0.0%	0	0.0%	0
10,000 to 15,000	0	0.0%	0	0.0%	0	1,700	2.6%	291,000	2.0%	171
15,000 to 20,000	500	1.8%	-50,000	1.5%	-100	1,800	2.7%	338,000	2.3%	188
20,000 to 25,000	700	2.6%	-64,000	1.9%	-91	2,700	4.1%	511,000	3.4%	189
25,000 to 30,000	1,100	4.0%	-138,000	4.1%	-125	3,700	5.6%	613,000	4.1%	166
30,000 to 40,000	5,600	20.4%	-641,000	19.1%	-114	8,000	12.1%	1,709,000	11.5%	214
40,000 to 50,000	9,700	35.4%	-1,417,000	42.3%	-146	10,800	16.3%	1,979,000	13.3%	183
50,000 to 60,000	4,500	16.4%	-526,000	15.7%	-117	12,200	18.4%	2,392,000	16.1%	196
60,000 to 80,000	1,800	6.6%	-139,000	4.2%	-77	11,400	17.2%	2,995,000	20.1%	263
80,000 to 100,000	1,400	5.1%	-66,000	2.0%	-47	6,300	9.5%	1,852,000	12.4%	294
100,000 to 200,000	1,100	4.0%	-132,000	3.9%	-120	5,700	8.6%	1,441,000	9.7%	253
200,000 to 300,000	400	1.5%	-46,000	1.4%	-115	1,100	1.7%	328,000	2.2%	298
300,000 and Over	600	2.2%	-129,000	3.9%	-215	900	1.4%	450,000	3.0%	500
TOTALS	27,400	100.0%	-$3,348,000	100.0%	-$122	66,300	100.0%	$14,899,000	100.0%	$225

Taxpayers With a Tax Change

Wisconsin Adjusted Gross Income	Count	Percent of Count	Amount of Tax Change	Percent of Amount	Average Change
Under $5,000	0	0.0%	$0	0.0%	$0
5,000 to 10,000	0	0.0%	0	0.0%	0
10,000 to 15,000	1,700	1.8%	291,000	2.5%	171
15,000 to 20,000	2,300	2.5%	288,000	2.5%	125
20,000 to 25,000	3,400	3.6%	447,000	3.9%	131
25,000 to 30,000	4,800	5.1%	475,000	4.1%	99
30,000 to 40,000	13,600	14.5%	1,068,000	9.2%	79
40,000 to 50,000	20,500	21.9%	562,000	4.9%	27
50,000 to 60,000	16,700	17.8%	1,866,000	16.2%	112
60,000 to 80,000	13,200	14.1%	2,856,000	24.7%	216
80,000 to 100,000	7,700	8.2%	1,786,000	15.5%	232
100,000 to 200,000	6,800	7.3%	1,309,000	11.3%	193
200,000 to 300,000	1,500	1.6%	282,000	2.4%	188
300,000 and Over	1,500	1.6%	321,000	2.8%	214
TOTALS	93,700	100.0%	$11,551,000	100.0%	$123

Comments:

This attachment shows the impact of all of the Governor's proposed income tax modifications, except the homestead credit expansion, on only those taxpayers affected by the social security provision in tax year 2001.

According to the 1997 sample, approximately 93,700 taxpayers would be affected by the social security provision under the Governor's proposal in 2001.

Of all affected taxpayers with a tax change, 27,400 (29.2%) would have a tax decrease. The average decrease would be $122.

Of all affected taxpayers with a tax change, 66,300 (70.8%) would have a tax increase. The average increase would be $225.

SOURCE: 1997 Wisconsin Tax Sample

State of Wisconsin
1999 – 2000 LEGISLATURE

LRBb0664/1
MES...:...:...
CMH

Soon

LFB:......Doty – Maintain current tax law treatment of social security

FOR 1999–01 BUDGET — NOT READY FOR INTRODUCTION

LFB AMENDMENT

TO 1999 ASSEMBLY BILL 133 AND 1999 SENATE BILL 45

At the locations indicated, amend the bill as follows:

1. Page 842, line 23: delete that line.

2. Page 1461, line 20: delete ", 71.05 (6) (b) 21.".

(END)

State of Wisconsin
1999 – 2000 LEGISLATURE

LRBb0664/1
MES:cmh:mrc

LFB:......Doty – Maintain current tax law treatment of social security

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