Joint Survey Committee on Tax Exemptions, March 16, 2000

Assembly Bill 860/Senate Bill 451 – Adopting Federal Internal Revenue Code Changes; Withholding by Purchaser of Lottery Prize

This bill adopts, for Wisconsin individual income and corporate income and franchise tax purposes, changes to the Internal Revenue Code (IRC) enacted through December 31, 2000. It also requires the purchaser of a lottery prize to withhold income tax from the payment made to the seller of the prize.

The Wisconsin income and franchise tax bases conform closely to the federal income tax bases. The state maintains conformity by adopting, each year, changes made to the IRC by Congress; AB 860/SB 451 is the vehicle for adopting the most recent changes to the IRC. Conformity to the federal tax base simplifies the calculation of state tax for individuals and businesses, since they can use federal income as the starting point of the state, rather than making a fresh computation of income.

The bill include several tax exemptions, all of which result in revenue losses to the state. However, other provisions increase state income and franchise tax revenues, so that the net effect of this bill is a $1.1 million revenue increase in FY01.

Exemptions in the bill include:

- Extension of the exclusion for employer-provided educational assistance to courses beginning before January 1, 2002. The exclusion had been scheduled to expire on June 1, 2000, and Wisconsin has allowed this exclusion for state purposes. The exclusion is allowed for tuition, fees, books, supplies and equipment up to $5,250 per year. This provision would reduce individual income tax revenues by $2.2 million in FY01.

- Extension of the election to expense certain environmental remediation costs to December 31, 2001. This election, which had been scheduled to expire after December 31, 2000, allows taxpayers to deduct these expenses immediately, rather than claiming depreciation deductions over several years. Wisconsin had previously adopted the expiring provision. This provision would reduce revenue by $0.1 million in FY01.

Additional provisions, which are not exemptions but rather increase revenues relate to (FY01 revenue gain indicated in parentheses):

- The treatment of gains from constructive ownership transactions involving financial assets and derivative contracts (+$0.2 million),

- Transfer of excess defined benefit pension plan assets to an account for retiree health benefits (+$0.1 million),

- Repeal of the installment method of accounting for accrual method taxpayers (+$2.9 million), and

- Changes in the treatment of real estate investment trusts (+$0.2 million).

The provision requiring purchasers of lottery prizes to withhold income tax from their payment to the sellers of the prize would help to ensure that the appropriate amount of tax is paid on the prize. The change is not expected to have a significant fiscal effect.

The Department of Revenue supports passage of this bill.

Prepared by: Dennis Collier, 266-5773
March 14, 2000

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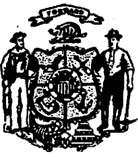

State of Wisconsin • **DEPARTMENT OF REVENUE**

125 SOUTH WEBSTER STREET • P.O.BOX 8933 • MADISON, WISCONSIN 53708-8933 • 608-266-6466 • FAX 608-266-5718 • http://www.dor.state.wi.us

Tommy G. Thompson
Governor

Cate Zeuske
Secretary of Revenue

DOR Testimony for Assembly Committee on Ways and Means
Wednesday, March 22, 2000

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Adopting Federal Internal Revenue Code Changes & Withholding by Purchaser of Lottery Prize

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CORRESPONDENCE/MEMORANDUM

STATE OF WISCONSIN
Department of Revenue

Date: March 27, 2000

To: Members, Assembly Committee on Ways and Means

From: Tom Ourada, Executive Assistant TO

Subject: IRC Update - Pension Assets for Retiree Benefits (AB 860 & SB 451)

In response to Rep. Wood's question regarding the provision of the IRC update that relates to pension assets for retiree benefits, I would like to provide further detail to expand on my comments at the committee's March 22 hearing.

This provision of the federal Tax Relief Extension Act of 1999 (Public Law 106-170) relates to corporate employers with defined benefit pension plans. The new law extends the past rule that allowed an employer to transfer excess assets from a defined benefit pension plan to an account within the same plan to pay for retiree health benefits (for those retirees entitled to receive such benefits upon retirement).

By transferring excess assets from the pension plan to a health benefits account within the same plan (referred to as a section 401(h) account), a corporation can avoid incurring the expense of paying for retiree health benefits. Rather, it can utilize the 401(h) account of the pension plan (which is exempt from income tax) to pay for those benefits. By avoiding the cost of funding the retiree health benefit expenditures, the profits (and corresponding taxable income) of the corporation will be higher to the extent of the avoided expense. The fiscal effect of higher corporate profits from this bill is estimated to be +$0.1 million in FY01 and +$0.2 in FY02.

The new law also affects the level of health benefits that are provided to retirees by replacing the minimum benefit standard with a minimum cost requirement. The minimum benefit standard required an employer to provide the same level of health benefits to retirees in the year of the transfer of excess assets and the four following years. The minimum cost requirement mandates that a group health plan or arrangement under which applicable health benefits are provided to retirees provide a minimum dollar level of retiree health expenditures for the year of the transfer and the following four years.

The new law maintains current provisions relating to reversions, disqualifications and prohibited transactions with respect to 401(h) accounts within a defined benefit pension plan. Therefore, the excess assets transferred from the pension plan to a 401(h) account are not included in gross income of the employer or subject to a federal excise tax on reversions.

If you have any questions, please feel free to contact me.