AGENCY: General Fund Taxes

LFB PAPER #: 1150

ISSUE: IRC Update

ALTERNATIVE: 1 and 4

SUMMARY:

Alternative 1 adopts the IRC updates from 2000 and 2001, brings us in compliance with federal tax laws.

Alternative 4 says that for the amortization updates, they have to have legislative approval, just like all other IRC updates & they don't get approved automatically. (This is Decker's amendment to SB 246)

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March 4, 2002 | Joint Committee on Finance | Paper #1150

Internal Revenue Code Update (General Fund Taxes)

[LFB Summary of the Governor's Budget Reform Bill: Page 46, #1]

CURRENT LAW

State tax provisions are generally referenced to definitions under federal law. With limited exceptions, changes to federal law take effect for state purposes only after action by the Legislature. Generally, the Legislature reviews the previous year's federal law changes each year to update state references to the Internal Revenue Code (IRC). With exceptions, current state tax provisions reference the code in effect as of December 31, 1999.

GOVERNOR

Update state tax references to the IRC to conform to federal law changes enacted through December 31, 2001, with one exception. Provide that the changes would apply for Wisconsin purposes at the same time as for federal purposes. Estimate the fiscal effect of adopting the provisions as a reduction in general fund tax revenues of $8.55 million in 2001-02 and $24.35 million in 2002-03, for a total reduction of $32.90 million for the 2001-03 biennium.

Most of the changes to federal law that affect the IRC were enacted under the following four federal acts: (a) the Foreign Sales Corporation Repeal and Extraterritorial Income Exclusion Act of 2000; (b) the Community Renewal Tax Relief Act, which was incorporated into the Consolidated Appropriations Act of 2000; (c) the Installment Tax Correction Act of 2000; and (d) the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which was the major federal tax legislation signed into law on June 7, 2001.

The excluded federal provision is an individual income tax deduction for payments made for higher education expenses in taxable years 2002 through 2005. The federal deduction is similar to (although broader than) a current state deduction for tuition expenses at higher education institutions in Wisconsin and in Minnesota under the Minnesota-Wisconsin reciprocity agreement.

The majority of items under the proposed IRC update are estimated to have a minimal or no fiscal effect. The following table provides a summary of the items that are estimated to have an impact on state revenues in the 2001-03 biennium.

Summary of Federal Law Changes with Substantive Fiscal Effects

	2001-02	2002-03
Individual Income Tax		
Expansion of Employer Adoption Assistance Exclusion	-$50,000	-$200,000
Increased Contributions to IRAs	-2,250,000	-5,950,000
Increase in Alternative Minimum Tax Exemption	Minimal	-200,000
Educational Assistance Programs	-2,700,000	-4,650,000
Education IRAs	-1,050,000	-2,250,000
Student Loan Interest Deduction	-900,000	-1,550,000
Individual Total	-$6,950,000	-$14,800,000
Corporate and Business Taxes		
Environmental Remediation Costs	Minimal	-$1,250,000
Corporate Donations of Computer Technology	Minimal	-1,100,000
Duplication or Acceleration of Loss Through Assumption of Certain Liabilities	Minimal	200,000
Foreign Sales Corporations	Minimal	-2,800,000
Corporate and Business Total	Minimal	-$4,950,000
Pension Provisions		
Increase in Contribution Limits	-$400,000	-$1,500,000
Benefit Limits Under Qualified Plans	-100,000	-250,000
Catch-Up Contributions	-500,000	-1,200,000
Increases in Defined Contribution Plan Limit	-200,000	-400,000
Repeal of Coordination Requirements for Section 457 Plan Limits	-50,000	-150,000
Increase in Employer Deduction Limits	Minimal	-100,000
Exclusion of Elective Deferrals in Determination of Deduction Limits	-200,000	-400,000
Treatment of Contributions to a Multi-Employer Plan	Minimal	-50,000
Repeal of the 160% Current Liability Funding Limit	-50,000	-100,000
Plan Loans for Small Business Owners	-100,000	-150,000
Rollovers to and from Governmental Plans and Tax-Sheltered Annuities	100,000	Minimal
Reinvestment of ESOP Dividends	-100,000	-250,000
Modification of Top-Heavy Rules	Minimal	-50,000
Pension Provisions Total	-$1,600,000	-$4,600,000
IRC Update Total*	-$8,550,000	-$24,350,000

*The estimated fiscal effect for 2002-03 under the bill was shown as -$24.45 million, rather than the -$24.35 million shown above, due to the inadvertent inclusion of an unrelated federal provision. However, it is the administration's intent to include the provisions and estimates shown above.

DISCUSSION POINTS

1. State references to federal law generally provide greater simplicity for taxpayers in preparing returns and reduce the administrative burden and cost for both taxpayers and the Department of Revenue (DOR) in assuring compliance with tax laws. The IRC references are used to determine which items of income are subject to taxation prior to specific state modifications. The state uses separate tax rates and brackets and separate provisions regarding standard deductions, itemized deductions and tax credits.

2. Under the bill, the IRC update provisions would apply for Wisconsin purposes at the same time as for federal purposes, including some items that would apply to tax year 2001. For such provisions, the Department of Revenue would include instructions with tax forms for 2002 to alert Wisconsin taxpayers to the changes related to the previous tax year (and the need for a taxpayer affected by a retroactive provision to file an amended return for 2001).

3. On June 7, 2001, President Bush signed into law the Economic Growth and Tax Relief Reconciliation Act of 2001. EGTRRA included a number of federal changes, such as tax rate reductions, the elimination of income-related limitations on itemized deductions and personal exemptions, relief from the marriage penalty and increases in child and dependent care tax credits, that would have no impact on state tax provisions, regardless of the version of the IRC referenced by state statutes.

4. However, EGTRRA also included many provisions that would lead to state revenue reductions under the proposed IRC update. Of the $32.90 million estimated cost of these provisions in the 2001-03 biennium, 85% ($27.95 million) relate to EGTRRA.

5. In order to comply with the Congressional Budget Act of 1974, EGTRRA included a sunset provision, which specified that EGTRRA provisions do not apply for taxable, plan or limitation years beginning after December 31, 2010. Under the bill, the same sunset provision would apply for state tax purposes.

6. The following sections highlight provisions under EGTRRA that would have the greatest impact on state tax revenues if adopted for state tax purposes. A paper by the Department of Revenue has been attached to provide information on all of the provisions under the proposed IRC update that would have more than a minimal fiscal effect on state taxes. The estimated fiscal effects shown in the paper are the same as those estimated under the bill. The projections are based on federal estimates of the effects of EGTRRA and are concurred with by this office.

INDIVIDUAL INCOME TAX

Increased Contributions to Individual Retirement Accounts

7. This provision would increase the maximum annual dollar contribution limit for individual retirement accounts (IRAs) from $2,000 to the following: (a) $3,000 for 2002 through 2004; (b) $4,000 for 2005 through 2007; and (c) $5,000 for 2008. The contribution limit would be

indexed for inflation in $500 increments thereafter.

In addition, individuals who have reached the age of 50 would be permitted to make catch-up IRA contributions. The catch-up limit would be $500 from 2002 through 2005 and $1,000 in 2006 and thereafter.

These provisions are estimated to reduce state income tax collections by $2.25 million in 2001-02 and by $5.95 million in 2002-03. The annual cost would increase to an estimated $26.75 million by 2008-09, when the scheduled increase in contribution limits would be fully phased-in.

Educational Assistance Programs

8. This provision would make permanent the exclusion for employer-provided education assistance, which had been set to expire for courses beginning after December 31, 2001, and would extend the exclusion to include graduate education. The exclusion is limited to $5,250 per year and is allowed for tuition, fees, books, supplies and equipment. The estimated cost is $2.70 million in 2001-02 and $4.65 million in 2002-03.

Education IRAs

9. An education IRA is a trust or custodial account created exclusively to pay the qualified higher education expenses of a single named beneficiary. These provisions would make multiple changes to education IRAs, effective for tax years starting after December 31, 2001, including but not limited to the following: (a) increase the annual contribution limit from $500 to $2,000; (b) raise the phase-out income level for married couples filing joint returns; and (c) expand the categories of expenses for which a taxpayer may make tax-free withdrawals. The estimated cost of these provisions is $1.05 million in 2001-02 and $2.25 million in 2002-03.

Student Loan Interest

10. Under these provisions, the phase-out income level on the student loan interest deduction would be increased, for tax years starting after December 31, 2001. In addition, the 60-month limitation for the number of months during which interest paid on a student loan is deductible would be repealed, as would the restriction that makes voluntary payments of interest nondeductible, effective with interest paid after December 31, 2001. The estimated cost of these provisions is $0.90 million in 2001-02 and $1.55 million in 2002-03.

11. The total fiscal effect of these and other income tax provisions is estimated to be a decrease in tax revenues of $6.95 million in 2001-02 and $14.80 million in 2002-03, gradually increasing to an estimated annual loss of $43.31 million in 2008-09 (when the increased limits in IRA contributions would be fully phased in).

Higher Education Expenses

12. The bill would exclude provisions under EGTRRA that create an income tax

deduction for tuition and fees for the enrollment or attendance at an eligible higher education institution for the taxpayer, the taxpayer's spouse or the taxpayer's dependent. The federal deduction is limited, depending on the taxpayer's adjusted gross income (AGI) and the tax year in which the deduction is claimed.

For 2002 and 2003, the deduction is limited to $3,000 of qualified expenses and is available to single taxpayers with AGI less than or equal to $65,000 ($130,000 for married couples filing joint returns). The deduction is not available to married taxpayers filing separately or to an individual who can be claimed as a dependent by another taxpayer.

For tax years 2004 and 2005, the same AGI ceilings apply but the maximum deduction increases to $4,000. In addition, a maximum deduction of $2,000 is available to taxpayers with AGI between $65,000 and $80,000 ($130,000 and $160,000 for joint filers) for tax years 2004 and 2005. The deduction is eliminated after 2005.

13. Under current law, the state provides a deduction of up to $3,000 in tuition expenses for post-secondary institutions in the state or in Minnesota under the Minnesota-Wisconsin tuition reciprocity agreement. A maximum deduction of $3,000 is available to single taxpayers with federal AGI of $50,000 or less, married-joint taxpayers with federal AGI of $80,000 or less and married-separate taxpayers with income of $40,000 or less. The deduction phases out as income increases and is eliminated when federal AGI exceeds $60,000 if single, $100,000 if married filing jointly and $50,000 if married filing separately.

14. The current state deduction is more limited than the new federal deduction in the following ways: (a) the state deduction applies only to tuition, while the federal deduction applies to tuition and fees; (b) the state deduction applies only to educational institutions in Wisconsin and Minnesota, while the federal deduction has no limits with respect to location; (c) the income limits under the state deduction are more restrictive than those that apply for the federal deduction; and (d) the maximum state deduction is $3,000 while the federal deduction increases to $4,000 in 2004 and 2005.

15. However, the state deduction is ongoing, whereas the federal deduction is eliminated after 2005. In addition, the state deduction is allowed for married individuals filing separately and for individuals claimed as dependents of other taxpayers, whereas such individuals are ineligible for the federal deduction.

16. Not adopting the federal deduction would complicate tax filing for the approximately 70,000 persons eligible for both the current Wisconsin deduction and the new federal deduction. Such taxpayers would have to complete Wisconsin Schedule I, on which they would have to add back the amount deducted from federal AGI for the federal deduction and then subtract the amount allowed for purposes of the state deduction to arrive at Wisconsin AGI. In some (but not all) cases, the amount of the federal deduction added back would be the same as the amount subtracted for the state deduction. However, taxpayers would still be required to show both modifications on Schedule I.

17. In addition, there could be other consequences of not adopting the federal deduction as a result of the discrepancy that would exist between federal AGI and federal AGI referred to for state tax purposes (which would exclude the higher education deduction). For example, the Wisconsin itemized deduction credit is based on federal itemized deductions, some of which are limited by federal AGI. If Wisconsin references an earlier version of federal AGI (as under current law), Wisconsin taxpayers using the federal education expense deduction would have to recalculate federal AGI without the deduction for the purpose of calculating the allowable Wisconsin itemized deduction credit.

18. One option that would avoid the complications described above would be to update state tax references to include the federal higher education expense deduction and to allow taxpayers to claim either the federal or the state deduction, but not both. Under this option, the state deduction would continue to be available to married taxpayers filing separately and to individuals who are dependents of other taxpayers, even though such filers are not eligible for the federal deduction. It is estimated that the fiscal effect would be a reduction in state tax revenues of $3.5 million in 2002-03.

19. Another option would be to conform to the federal deduction and to eliminate the existing state deduction. This alternative would be the most simple administratively, for taxpayers as well as for DOR. Under this option, taxpayers would determine the higher education deduction for federal tax purposes and it would flow through for state tax purposes as part of federal AGI. There would be no need to make Schedule I modifications to get the deduction at the state level. However, several thousand taxpayers who are eligible for the existing state deduction but not for the federal deduction would lose eligibility for any deduction under this option. It is estimated that the fiscal effect would be a decrease in state tax revenues of $2.3 million in 2002-03.

PENSION PROVISIONS

20. Under the bill, the state would conform to the many revisions in retirement savings laws enacted under EGTRRA. Significant changes would be made with respect to pension contributions and funding. Among these changes would be increases in limits for the following: (a) contributions to qualified retirement plans; (b) benefit limits under defined benefit plans; (c) employer deduction limits for qualified plan contributions; and (d) elective deferrals under deferred compensation plans. In addition, catch-up contributions in the form of higher limits for elective deferrals would be authorized for employees age 50 and older. The limits on elective deferrals and catch-up contributions would be phased in over a number of years.

21. Effective with tax year 2006, EGTRRA also authorizes certain types of qualified plans to offer a Roth contribution program, in which all or a portion of allowable elective deferrals could be designated as after-tax contributions. As under a Roth IRA, earnings and distributions under such a program would be tax-free.

22. Additional changes were enacted under EGTRRA in the areas of pension distributions and rules on nondiscrimination and coverage. Under the bill, the state would adopt these revisions, including (but not limited to) the following: (a) tax-free rollovers permitted among a

variety of retirement plans; (b) repeal of special minimum distribution rules that had applied only to deferred compensation plans sponsored by state and local governments and tax-exempt organizations; (c) expanded deductions for certain dividends paid to an employee stock ownership plan and reinvested in qualified employer securities; and (d) modification of top-heavy rules that would reduce the number of plans deemed top-heavy and therefore subject to the special rules. More information on these and all of the pension provisions can be found in the attached paper by DOR.

23. While certain changes are phased-in over time, the revisions in federal pension law are generally effective with years beginning after December 31, 2001. Adopting the pension provisions for state purposes would decrease state tax revenues by an estimated $1.60 million in 2001-02 and $4.60 million in 2002-03. It is expected that the reduction in state tax revenues would be approximately $8.5 million in 2006-07, when all phased-in changes would be effective.

24. As is generally the case with individual and corporate income tax provisions, conforming state references to federal law with respect to retirement savings would provide greater simplicity for Wisconsin taxpayers. In addition, conforming to current federal law would enable Wisconsin taxpayers to take advantage of some of the federal revisions that they might not be able to utilize in the absence of a state law change.

25. For example, EGTRRA raised the limit on elective deferrals under IRC section 457 deferred compensation programs of tax-exempt organizations and state or local government plans to $11,000 (the limit had been $8,500 in 2001, and would have been increased for inflation under prior federal law). Without a change in current state law, elective deferrals through the Wisconsin Deferred Compensation program would be held to the deferral limits under prior federal law.

CORPORATE AND BUSINESS TAX PROVISIONS

26. The remaining IRC update provisions that would have a fiscal effect relate to federal laws enacted in 2000 and concern corporate and other business tax provisions. With exceptions, the three federal laws enacted in 2000 (described under "Governor," above) were included in the state 2001-03 biennial budget as passed by the Legislature. However, the Governor vetoed these provisions because, as passed by the Legislature, the budget bill inadvertently adopted three provisions that were not intended to be included.

27. The budget reform bill would update state tax references to the three federal laws enacted in 2000. The following sections briefly describe the new federal provisions that would have a state fiscal effect.

Environmental Remediation Costs

28. The expiration date for the election to deduct certain environmental remediation expenditures that would otherwise be charged to a capital account would be extended to include

expenses paid or incurred before 2004. The requirement that expenditures be in a targeted area would be eliminated so that most other sites certified by state environmental agencies as containing hazardous substances are eligible. This provision is effective for expenditures made after December 21, 2000. The estimated fiscal effect is a revenue decrease of $1.25 million in 2002-03.

Corporate Donations of Computer Technology

29. The expiration date for deductions of certain computer equipment donated to elementary and secondary schools would be extended through 2003. The deduction would be extended to include donations to public libraries, donations of property up to three years after acquisition, rather than two years under prior law, and donations of property reacquired by a computer manufacturer. This provision applies to donations made after December 31, 2000. The estimated fiscal effect is a revenue decrease of $1.1 million in 2002-03.

Duplication or Acceleration of Loss Through Assumption of Certain Liabilities

30. The basis of stock received in certain tax-free exchanges would be required to be reduced by the amount of any liability assumed in exchange for the stock that does not otherwise reduce the transferor's basis. Stock could not be reduced below its fair market value. The provision would generally not apply if the trade or business with the liability or substantially all of the assets associated with the liability is transferred to the corporation in the exchange. This provision is effective for assumption of liabilities on or after October 19, 1999. The estimated fiscal effect is a revenue increase of $0.20 million in 2002-03.

Foreign Sales Corporations

31. The present foreign sales corporation (FSC) rules would be repealed and replaced with an exclusion for extraterritorial income. The tax benefit under the exclusion is expected to mirror the tax benefit under the FSC rules, but apply to a greater number of taxpayers. Corporations could use the new benefit directly rather than having to create specifically defined FSC subsidiaries.

The law change is in response to a decision by the World Trade Organization (WTO) that the FSC provisions breach WTO rules by providing subsidies to assist U.S. exports, thus giving U.S. companies an unfair advantage in international trade. The European Union initially brought the complaint to the WTO and has indicated that it expects to ask the WTO to rule on the new scheme, suggesting that it may still not be compliant with WTO rules. Regardless of whether the new scheme would ultimately withstand such a challenge, it would remain in effect during the dispute.

This provision is effective for transactions entered into after September 30, 2000. No corporation may elect to be an FSC after that date. Transition rules are included for current FSCs. The estimated fiscal effect is a revenue decrease of $2.80 million in 2002-03.

32. It was the Legislature's intent to exclude the provisions regarding environmental remediation costs, donations of computer equipment and foreign sales corporations from the IRC

update adopted in the biennial budget bill last summer in order to avoid the associated revenue loss. As described above, these provisions would be included in the current IRC update recommended by the Governor.

TREATMENT OF AMORTIZATION AND DEPRECIATION

33. As, noted, state tax provisions are generally referenced to federal definitions under the federal IRC and changes in federal law take effect for state tax purposes only after action by the Legislature. However, the Legislature does not have to take action to reference state tax provisions related to amortization and depreciation to the federal IRC. Specifically, for property placed in service on or after January 1, 2000, amortization or depreciation may be computed under either the federal IRC as amended to December 31, 1999, or the federal IRC in effect for the tax year for which the return is filed. As a result, Wisconsin automatically adopts federal IRC provisions for computing amortization or depreciation.

34. This automatic referencing to federal IRC provisions provides taxpayers with the benefits of any federal tax reductions. Conforming state tax treatment of depreciation and amortization with federal law greatly simplifies state tax accounting for taxpayers. However, if federal law is modified to increase depreciation or amortization deductions, state tax revenues could be significantly reduced as a result of the federal law change. As a result, the Committee may wish to delete the current law provisions that permit taxpayers to compute amortization or depreciation under the federal IRC in effect the tax year for which the return is filed. Rather, federal amortization and depreciation provisions could be adopted for state tax purposes only after action by the Legislature. Amortization and depreciation provisions would be treated as most other federal IRC provisions. There would be no fiscal effect related this change in treatment.

ALTERNATIVES TO BILL

1. Adopt the Governor's recommendation to update state statutes to conform to provisions under the four federal laws described above, with the exception of an individual income tax deduction for higher education expenses. In addition, reduce the estimated revenue loss in 2002-03 under the bill by $100,000, to reflect the administration's intended estimate. Compared to current law, the fiscal effect would be a reduction in general fund tax revenues of $8,550,000 in 2001-02 and $24,350,000 in 2002-03, for a total reduction of $32,900,000 for the 2001-03 biennium.

Alternative 1	GPR
2001-03 REVENUE	$100,000

2. Adopt Alternative 1. In addition, include as part of the IRC update the federal individual income tax deduction for higher education expenses. Specify that a taxpayer could use either the federal or the state deduction, but not both.

Compared to current law, the fiscal effect would be to reduce general fund tax revenues by $8,550,000 in 2001-02 and $27,850,000 in 2002-03, for a total reduction of $36,400,000 for the 2001-03 biennium. As compared to the bill, this option further reduce state tax revenues by an estimated $3,400,000 in 2002-03 (a loss of $3,500,000 from the higher education deduction and a gain of $100,000 from the correction to the administration's estimate).

Alternative 2	GPR
2001-03 REVENUE	- $3,400,000

3. Adopt Alternative 1. In addition, modify the provisions to include the federal individual income tax deduction for higher education expenses and to eliminate the current state deduction for tuition expenses. Compared to current law, the fiscal effect would be a reduction in general fund tax revenues of $8,550,000 in 2001-02 and $26,650,000 in 2002-03, for a total reduction of $35,200,000 for the 2001-03 biennium. As compared to the bill, this option would decrease state tax revenues by an additional $2,200,000 in 2002-03 (a loss of $2,300,000 from the higher education deduction and a gain of $100,000 from the correction to the administration's estimate).

Alternative 3	GPR
2001-03 REVENUE	- $2,200,000

4. Delete current law provisions that permit taxpayers to compute amortization or depreciation under the federal IRC in effect for the tax year for which the return is filed and provide that federal amortization and depreciation provisions could be adopted for state tax purposes only after action by the Legislature.

5. Maintain current law.

Alternative 5	GPR
2001-03 REVENUE	$33,000,000

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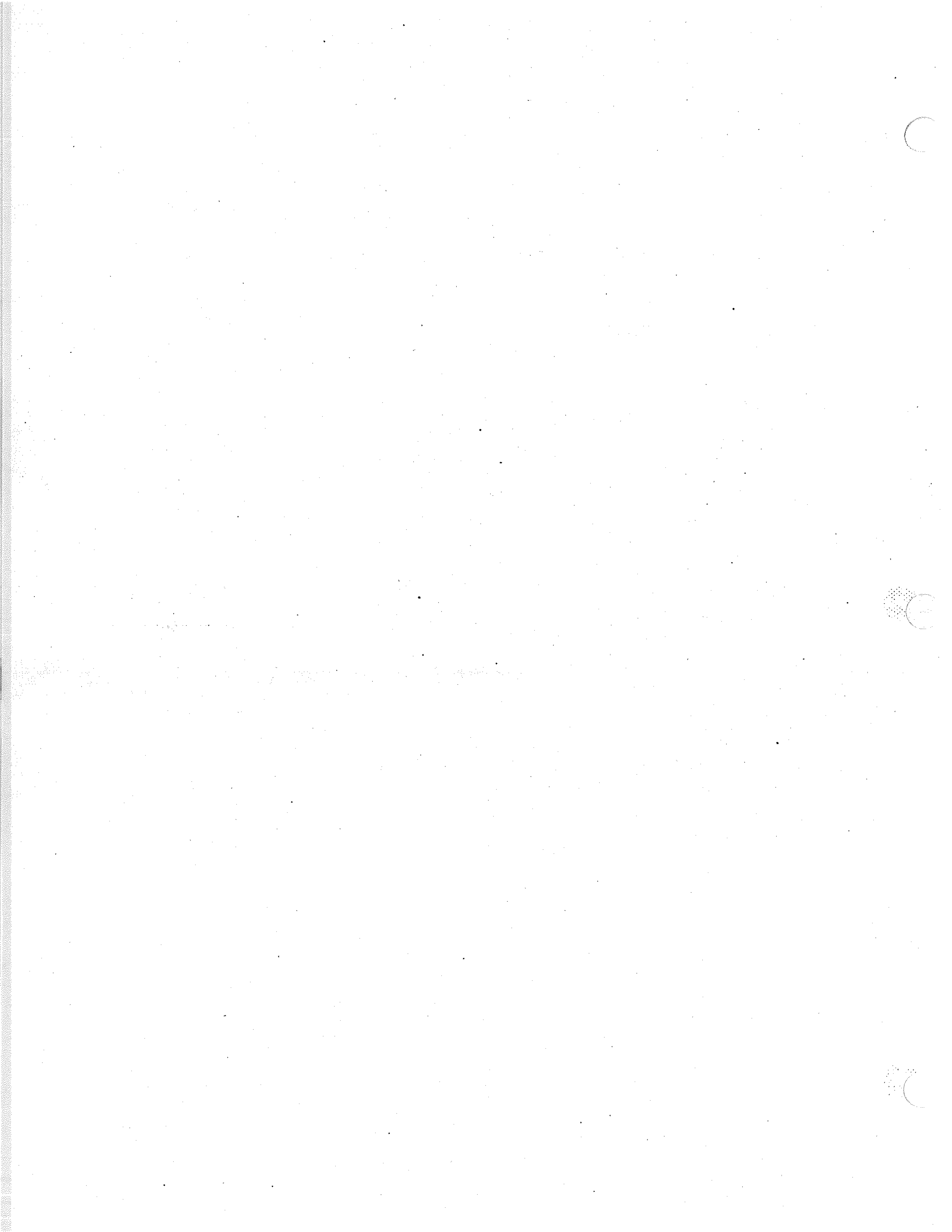
INTERNAL REVENUE CODE UPDATE

LAWS ENACTED THROUGH DECEMBER 31, 2001

Wisconsin Department of Revenue
Division of Research and Policy
January 31, 2002



Wisconsin Department of Revenue
Division of Research and Policy
January 31, 2002

INTERNAL REVENUE CODE UPDATE – LAWS ENACTED THROUGH DECEMBER 31, 2001

Wisconsin's individual income and corporate income and franchise tax bases closely conform to the bases for the federal individual and corporate income taxes through references in Chapter 71 of the Wisconsin Statutes to the federal Internal Revenue Code. To maintain conformity, these references must be updated each year.

During 2001, one federal law was enacted affecting income tax law: the Economic Growth and Tax Relief Reconciliation Act of 2001. In addition, three federal laws were enacted during 2000, but have not been adopted for Wisconsin tax purposes. These are the Federal Sales Corporation Repeal and Extraterritorial Income Exclusion Act (FSCRA), the Community Renewal Tax Relief Act (CRTRA), which was incorporated into the Consolidated Appropriations Act, and the Installment Tax Correction Act (ITCA).

The federal laws enacted in 2000 were included in enrolled Senate Bill 55, the state budget bill, but vetoed by the governor because the bill inadvertently adopted three provisions that the legislature had intended to exclude because of their fiscal impact. These were deductions for environmental remediation expenses and corporate donations of computers, and the treatment of foreign sales corporations. Subsequent legislation, Senate Bill 246 and Assembly Bill 506, to adopt the FSCRA, CRTRA and ITCA was introduced in both houses of the legislature, but not enacted.

This paper describes the changes in these four federal laws that have substantive impacts on state tax policy. Adoption of all provisions of these federal laws for state tax purposes, with one exception, is recommended. That recommendation includes adoption of the three provisions that the legislature intended not to adopt in enrolled SB 55. The exception, the provision not being recommended for adoption, is the deduction for higher education expenses, enacted in EGTRRA. Wisconsin already provides a deduction targeted to tuition at the state's institutions of higher education.

The fiscal effect of the changes recommended for adoption, summarized by item in the following table, is estimated to be -$8.55 million in FY02 and -$24.35 million in FY03.

Federal Tax Change*	Federal Law	Effective Date	Fiscal Effect ($ mill) FY02	FY03
Individual Income Tax Provisions				
Expansion of Employer Adoption Assistance Exclusion	EGTRRA	1/1/02	-$0.05	-$0.20
Increased Contributions to IRAs	EGTRRA	1/1/02	-2.25	-5.95
Increase in AMT Exemption	EGTRRA	1/1/01	Min	-0.20
Educational Assistance Programs	EGTRRA	1/1/02	-2.70	-4.65
Education IRAs	EGTRRA	1/1/02	-1.05	-2.25
Student Loan Interest Deduction	EGTRRA	1/1/02	-0.90	-1.55
Corporate and Other Business Tax Provisions				
Environmental Remediation Costs	CRTRA	12/22/00	Min	-1.25
Corporate Donations of Computer Technology	CRTRA	1/1/01	Min	-1.10
Duplication or Acceleration of Loss Through Assumption of Certain Liabilities	CRTRA	10/19/99	Min	+0.20
Foreign Sales Corporations	FSCRA	10/1/00	Min	-2.80
Pension Provisions				
Increase in Contribution Limits	EGTRRA	1/1/02	-0.40	-1.50
Benefit Limits under Qualified Plans	EGTRRA	1/1/02	-0.10	-0.25
Catch-up Contributions	EGTRRA	1/1/02	-0.50	-1.20
Increases in Defined Contribution Plan Limit	EGTRRA	1/1/02	-0.20	-0.40
Repeal of the Coordination Requirements for Section 457 Plan Limits	EGTRRA	1/1/02	-0.05	-0.15
Increase in Employer Deduction Limits	EGTRRA	1/1/02	Min	-0.10
Exclusion of Elective Deferrals in Determination of Deduction Limits	EGTRRA	1/1/02	-0.20	-0.40
Treatment of Contributions to a Multiemployer Plan	EGTRRA	1/1/02	Min	-0.05
Repeal of the 160% Current Liability Funding Limit	EGTRRA	1/1/02	-0.05	-0.10
Plan Loans for Small Business Owners	EGTRRA	1/1/02	-0.10	-0.15
Rollovers to and from Governmental Plans and Tax-Sheltered Annuities	EGTRRA	1/1/02	+0.10	Min
Reinvestment of ESOP Dividends	EGTRRA	1/1/02	-0.10	-0.25
Modification of Top-Heavy Rules	EGTRRA	1/1/02	Min.	-0.05
Total			-$8.55	-$24.35

* Does not include earned income tax credit increase and simplification enacted in EGTRRA, which Wisconsin adopts automatically by piggybacking on the federal credit. This provision will increase spending on the EITC by $1.90 million in FY03 (to the extent that this increased credit is refunded to taxpayers, it may be is financed by federal Temporary Assistance for Needy Families funds).

A. INDIVIDUAL INCOME TAX

1. Expansion of Employer Adoption Assistance Exclusion

Federal Change: EGTRRA doubles the maximum amount of the exclusion from income for employer-provided adoption assistance to $10,000 per eligible child. The amount will be adjusted annually to reflect inflation beginning in tax year 2003. The starting point for phase-out of the exclusion is increased to $150,000 of modified adjusted gross income (AGI).

Effective Date: Taxable years beginning after December 31, 2001.

Fiscal Effect: -$0.05 million in FY02, -$0.20 million in FY03.

2. Increased Contributions to IRAs

Federal Change: EGTRRA increases the maximum annual contribution to an Individual Retirement Account (IRA) over the next seven years until it reaches $5,000 in 2008, after which the maximum will be adjusted annually for inflation. Individuals who are over age 50 are also allowed to make additional "catch-up contributions" to an IRA.

Currently, individuals are permitted to contribute up to $2,000 annually to either a traditional or a Roth IRA. This amount has remained unchanged since 1981; it has been estimated that the IRA contribution limit would have reached about $5,000 in 1999 if it had been indexed for inflation.

The new annual contribution limits for IRAs are:

Tax Year	Younger Than Age 50	Age 50 Or Older
2002 - 2004	$3,000	$3,500
2005	4,000	4,500
2006 - 2007	4,000	5,000
2008 and after	5,000	6,000

Effective Date: Taxable years beginning after December 31, 2001.

Fiscal Effect: -$2.25 million in FY02, -$5.95 million in FY03.

3. Deemed IRAs under Employer Plans

Federal Change: Under EGTRRA, an employer with a qualified retirement plan may set up traditional or Roth IRAs on behalf of their employees without affecting the qualified status of any other qualified retirement plan of the employer. These "deemed IRAs" are not subject to the IRC rules that apply to retirement plans, however, reporting requirements that apply to traditional and Roth IRAs will also apply to deemed IRAs.

Effective Date: Plan years beginning after December 31, 2002.

Fiscal Effect: Minimal.

4. Increase in AMT Exemption

Federal Change: EGTRRA increases the alternative minimum tax (AMT) exemption amounts for individual income tax filers for tax years 2001 through 2004. The AMT exemption amount for estates and trusts will remain unchanged. EGTRRA also clarifies that the maximum amount of the exemption phase-out will be the same for married separate and married joint filers. Finally, EGTRRA makes permanent the provision allowing the child credit to be claimed against the AMT and repeals the AMT offset of refundable credits. Under current law, Wisconsin's exemption amounts are the same as the federal amounts.

The AMT is designed to impose tax on high-income taxpayers who would otherwise avoid tax by using certain deductions and credits. The AMT exemption amounts are designed to prevent taxpayers with low levels of tax benefits from paying the AMT, and these exemptions phase out, at a rate of 25%, over higher income ranges to prevent taxpayers with exceptionally large amounts of tax preference items from claiming the exemption. However, because the exemption limits have not been indexed for inflation, a growing number of taxpayers are subject to the AMT each year.

EGTRRA increases the exemption amounts by $2,000 for single, head of household and married separate filers and by $4,000 for married joint filers. Phase-out floors remain the same, but the increase in exemption amounts leads to higher phase-out ceilings. The table below summarizes the AMT exemption amounts and phase-out ranges under prior law and EGTRRA.

ALTERNATIVE MINIMUM TAX CHANGES, TAX YEAR 2001

Filing Status	Maximum Exemption	Phase-out Floor	Phase-out Ceiling
	Prior Law		
Single, Head of Household	$33,750	$112,500	$247,500
Married Joint	45,000	150,000	330,000
Married Separate	22,500	75,000	165,000
	New Law		
Single, Head of Household	$35,750	$112,500	$255,500
Married Joint	49,000	150,000	346,000
Married Separate	24,500	75,000	173,000

Effective Date: Tax years beginning after December 31, 2000. However, the increase in the AMT exemption amount will not apply for tax years beginning in 2005 or thereafter.

Fiscal Effect: -$0.20 million in FY03.

5. Qualified Retirement Planning Services

Federal Change: EGTRRA excludes employer-provided qualified retirement planning services for employees and their spouses from the employees' gross wages. In order for the retirement planning services to qualify for the exclusion, the employer must sponsor a qualified retirement plan.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal.

6. Exclusion for Restitution Payments to Victims of Nazi Persecution

Federal Change: Under EGTRRA, "excludable restitution payments" received by eligible individuals, their heirs or estates are not included in gross income. The basis of any property received by eligible individuals, their heirs or estates as part of an excludable restitution payment is the fair market value of the property at the time of receipt. Previously, reparation payments received by victims of Nazi persecution generally were not excludable from income, though certain reparations were excluded because they were payments for personal injuries and other losses of rights.

An eligible individual is defined as any person who was persecuted on the basis of race, religion, physical or mental disability, or sexual orientation by Nazi Germany, any other Axis regime, or any other Nazi-controlled or Nazi-allied country.

An excludable restitution payment is a payment or distribution to an individual that:

- is payable by reason of the individual's status as an eligible individual;
- constitutes the return of or compensation for assets stolen or hidden from the individual before, during or after World War II as a result of the individual's status as an eligible individual; or
- consists of interest payable as part of any payment or distribution described in the first two points.

Effective Date: Amounts received on or after January 1, 2000.

Fiscal Effect: Minimal revenue loss.

7. Repeal of Stepped-up Basis

Federal Change: EGTRRA modifies the basis rules for purposes of the individual income tax due to the estate tax changes in the act. The changes will not take effect until the federal estate tax is eliminated, after 2009.

EGTRRA replaces the step-up rule for the basis of property received from a decedent at death or from a donor with a carryover rule. Under prior law, basis of property transferred at death or by gift was "stepped-up" to equal the value of the property as of the date of the decedent's death or the date of the gift. This allowed the recipient of the property to avoid tax on any gain that may have occurred during the decedent's lifetime. Under EGTRRA, the basis of property transferred by the donor becomes the basis in the hands of the recipient—that is, the donor's basis is "carried over" to the recipient. Specifically, the basis carried over to the recipient is equal to the lesser of the adjusted basis of the property in the hand of the decedent or the fair market value of the property on the date of the decedent's death.

Other changes in basis rules in EGTRRA include the following:

- Income that the decedent had an enforceable right to during life but did not receive until after death is not subject to the new carryover basis at death rules.
- The income tax exclusion of gain from the sale of a principal residence is extended to sales by a decedent's estate, heir or qualified revocable trust. The decedent's ownership and use of the property will be taken into account when calculating the exclusion: the property must have been owned and occupied as a principal residence by the decedent for at least two years during the five-year period prior to the sale. The maximum exclusion allowed is $250,000, and must be prorated if the ownership and occupancy requirements are not met, conforming to the exclusion allowed to ordinary individual taxpayers. Further, an heir who occupies a decedent's property as his or her principal residence is allowed to include the decedent's period of occupancy for purposes of claiming the exclusion.

In addition, several sections of the IRC were amended to maintain current treatment that otherwise would be changed by EGTRRA. These include:

- the recognition-of-gain rule is expanded to transfers of property to nonresidents;
- inherited artwork and similar property are not subject to capital gain treatment;
- charitable split-interest trusts will be subject to excise tax; and
- the term "executor" will be defined as an executor or administrator of the decedent, or if one is not appointed or qualified, then any person in possession of any of the decedent's property.

Effective Date: Transfers after December 31, 2009.

Fiscal Effect: None in the current biennium.

8. Severing of Trusts

Federal Change: Trusts created via a "qualified severance" of a single trust will be treated as separate trusts for purposes of the generation-skipping transfer (GST) tax. Previously, the division of a single trust into two or more trusts was not recognized for GST tax purposes.

EGTRRA defines a "qualified severance" as the division of a single trust into two or more trusts where the single trust was divided on a fractional basis and the terms of the new trusts provide for the same succession of interests as was provided in the original trust.

Effective Date: Severances after December 31, 2000.

Fiscal Effect: Minimal.

9. Educational Assistance Programs

Federal Change: The exclusion for employer-provided educational assistance is made permanent and is extended to cover expenses paid by an employer for graduate-level courses. Previously, the exclusion did not apply to graduate-level courses and was scheduled to expire for courses beginning after December 31, 2001. The exclusion is allowed for tuition, fees, books, supplies and equipment, and is limited to $5,250 per year.

Effective Date: Courses beginning after December 31, 2001.

Fiscal Effect: -$2.70 million in FY02, -$4.65 million in FY03.

10. Qualified State Tuition Programs

Federal Change: Distributions from qualified state tuition programs are tax-free beginning in tax year 2002. Additionally, qualified tuition programs (QTPs) are no longer limited to state-sponsored plans and may also be offered by private institutions. Distributions from private QTPs are tax-deferred in tax year 2002, and are made tax-free beginning in tax year 2004. EGTRRA also allows taxpayers to exclude QTP distributions from gross income and claim the Hope or Lifetime Learning tax credits only if the QTP distribution and credits are not used with respect to the same expenses. Finally, EGTRRA expands the definition of family member for purposes of QTPs, removes the limit on room and board expenses, eases rollover limitations, and clarifies the coordination of claims for education credits with distributions received from an education IRA and QTP in the same tax year.

QTPs allow contributors to purchase tuition credits or certificates on behalf of a designated beneficiary entitling the beneficiary to a waiver or payment of qualified higher education expenses. The tax on earnings attributable to prepayments or contributions is deferred until earnings are distributed to the beneficiary, who then pays taxes on the earnings, often at a lower tax rate than that of the contributor.

Currently, because the amount of a QTP distribution is included in the beneficiary's taxable income, the beneficiary may also claim a Hope or Lifetime Learning credit to the extent that the distribution was used to pay tuition or other qualified expenses. Because EGTRRA now excludes QTP distributions from gross income (beginning in tax year 2002 for state plans; 2004 for private plans), the Hope or Lifetime Learning credit may only be claimed if they are not used with respect to the same expenses as the QTP distribution.

Currently, credits (or other amounts) may be transferred without penalty from an account benefiting one beneficiary to another account benefiting a different beneficiary, but only if both beneficiaries are members of the same family, which is defined to include only immediate family members. Further, withdrawals or distributions from QTPs must be used to pay for qualified higher education expenses, which include only a limited amount of room and board expenses. EGTRRA extends both of these provisions, allowing credits to also be transferred without penalty between first cousins, and removing the limitation on the amount of room and board expenses that may be paid for using QTP distributions.

Wisconsin already exempts from income tax most interest earnings on a prepaid tuition plan or college savings plan provided the distributions from the plan are used for qualified educational purposes.

Effective Date: Taxable years beginning after December 31, 2001, except that exclusion for distributions from QTPs established and maintained by an entity other than a state applies for distributions made in taxable years beginning after December 31, 2003.

Fiscal Effect: Minimal (because of the existing Wisconsin deduction earnings on certain prepaid tuition and college savings plans).

11. National Health Service Corps and Armed Forces Scholarships

Federal Change: Amounts received from the National Health Service Corps (NHSC) or the Armed Forces Scholarship Program for tuition, fees, books, supplies, and equipment required in the course of instruction are excluded from the student's gross income. Amounts received as stipends for living expenses, such as room and board remain taxable.

The NHSC scholarship program covers the cost of tuition and fees and provides a monthly stipend to cover living expenses in exchange for the student's agreement to provide medical services in a community determined by the Public Health Service to have a shortage of health-care professionals. The Armed Forces Scholarship Program requires recipients to serve a certain number of years in the military at an armed forces medical facility.

Because the NHSC and Armed Forces Scholarship Programs both require federal service after the student has completed his or her degree program, these amounts were not previously considered "qualified scholarships."

Effective Date: Amounts received in taxable years beginning after December 31, 2001.

Fiscal Effect: Minimal.

12. Education IRAs

Federal Change: EGTRRA raises the annual contribution limit on education IRAs from $500 to $2,000. It also allows corporations and other entities to contribute to education IRAs, and allows contributions for a taxable year to be made until April 15 of the following year, the same treatment already allowed for traditional and Roth IRAs.

The federal changes also modify the phase-out range for high-income contributors filing joint returns. Previously, the allowable contribution amount was phased out for married joint filers with modified adjusted gross income (AGI) between $150,000 and $160,000; EGTRRA raises this range to between $190,000 and $220,000 of modified AGI. The phase-out range for single filers remains between $95,000 and $110,000.

As with the changes to qualified tuition plans, federal changes to education IRAs will allow a taxpayer to exclude education IRA distributions from gross income and to claim the Hope or Lifetime Learning credits as long as they are not used with respect to the same educational expenses. This repeals the previous requirement that filers must waive the tax-free treatment for distributions from an education IRA in order to claim an education tax credit in the same tax year.

The excise tax on contributions made to an education IRA when a contribution is made on behalf of the same beneficiary to a qualified tuition plan (QTP) is also repealed. Prior to EGTRRA, a 6% excise tax was imposed on contributions made to an education IRA that exceeded the allowed annual limit or that were contributed to a qualified state tuition plan for the same beneficiary.

EGTRRA also allows education IRA contributions to continue to be made even after the beneficiary has reached the age of 18 if the beneficiary is deemed to have special needs. In the case of special needs beneficiaries, the 30-year age limit for mandatory distributions of any remaining balance in an education IRA may also be disregarded. For beneficiaries without special needs, contributions continue to cease when the beneficiary reaches the age of 18 and any remaining account balance is be distributed within 30 days after the beneficiary's 30th birthday.

Finally, EGTRRA allows education IRA distributions to be used for elementary and secondary school expenses and expands the definition of "qualified expenses" to include computer technology, equipment or services. Previously, distributions could be used only for qualified higher education expenses, which were limited to tuition, fees, books, supplies, and room and board if the student was enrolled at least part-time.

Effective Date: Taxable years beginning after December 31, 2001.

Fiscal Effect: -$1.05 million in FY02, -$2.25 million in FY03.

13. Student Loan Interest Deduction

Federal Change: EGTRRA increases the modified adjusted gross income (AGI) phase-out ranges for eligibility for the student loan interest deduction and adjusts them annually for inflation after tax year 2002. Additionally, both the 60-month limitation on the number of months during which interest is deductible and the restriction making voluntary interest payments nondeductible are repealed.

Under prior law, the maximum allowable student loan interest deduction was $2,500 and was phased out for single taxfilers with modified AGI between $40,000 and $55,000 and for married joint filers with modified AGI between $60,000 and $75,000. EGTRRA maintains the maximum deduction amount of $2,500, but increases the phase-out ranges to between $50,000 and $65,000 for single filers and between $100,000 and $130,000 for married joint filers.

Effective Date: The provisions increasing the phase-out limits apply to taxable years ending after December 31, 2001; the provisions eliminating the 60-month payback period apply to loan interest paid after December 31, 2001.

Fiscal Effect: -$0.90 million in FY02, -$1.55 million in FY03.

14. Deduction for Higher Education Expenses

Federal Change: EGTRRA provides a new above-the-line deduction for qualified higher education expenses to individual income taxpayers beginning in tax year 2002. The amount of the deduction is limited to taxpayers with AGI below specified ceilings, and married persons filing separately and dependents on another taxpayer's return are not eligible for the deduction.

For tax years 2002 and 2003, the deduction is limited to $3,000 and is only available to taxpayers with AGI not exceeding $65,000 ($130,000 for joint filers); in 2004 and 2005, the maximum deduction increases to $4,000. Taxpayers with AGI between $65,000 and $80,000 ($130,000 and $160,000 for joint filers) may deduct up to $2,000 in tax years 2004 and 2005. The deduction is eliminated after 2005.

Because Wisconsin already provides a deduction for tuition expenses, adoption of this provision is not recommended. Under current law, Wisconsin tax filers may deduct up to $3,000 per year for tuition at post-secondary institutions located in Wisconsin or located in Minnesota and covered under Minnesota-Wisconsin tuition reciprocity. The Wisconsin deduction is phased out as income rises, between $50,000 and $60,000 of federal adjusted gross income (FAGI) for single and head of household filers, $80,000 and $100,000 of FAGI for married couples filing jointly and $40,000 and $50,000 of FAGI for married separate filers.

Should the legislature decide to adopt this federal provision, it is recommended that the Wisconsin deduction be disallowed for anyone claiming the federal deduction. This change would prevent some taxpayers from deducting the same expenses twice and prevent others from deducting more than the $3,000 intended under federal law.

The potential for a double deduction would occur, if this federal deduction was adopted, because FAGI is the starting point for calculating Wisconsin income tax. Thus, a filer with tuition expenses of $2,500 could deduct $2,500 in determining FAGI and then, using the current Wisconsin deduction, subtract $2,500 again in determining Wisconsin adjusted gross income (WAGI). As a result, the total deduction for Wisconsin purposes would be $5,000, even though tuition expenses were only $2,500.

A deduction of more than $3,000 could occur for taxpayers with tuition expenses in excess of this amount. For instance, a tax filer with tuition of at least $6,000 would be able to deduct $3,000 from FAGI and an additional $3,000 from FAGI in the determination of WAGI, for a total deduction of $6,000.

Effective Date: Payments made in taxable years beginning after December 31, 2001. The deduction will not be available in tax years beginning after December 31, 2005.

Fiscal Effect: None because adoption of this provision is not recommended. (If the provision is adopted, the fiscal effect would be -$8.00 million in FY02, -$13.35 million in FY03. Limiting the current Wisconsin deduction to taxpayers not taking the federal deduction would reduce this revenue loss.)

15. Earned Income Tax Credit Increase and Simplification

Federal Change: EGTRRA increased the earned income tax credit (EITC) phase-out floor and ceiling for married couples filing jointly, and made several other changes intended to simplify the credit. The higher phase-out ceiling is intended to reduce the marriage penalty on married EITC claimants. The phase-out floor and ceiling for joint filers are increased by $1,000 for tax years 2002 through 2004, by $2,000 for tax years 2005 through 2007 and by $3,000 for tax years beginning after 2007.

Other changes to the EITC include:

- a revision of the definition of earned income to exclude all forms of nontaxable employee compensation;
- a change in the computation of the credit from one based on modified adjusted gross income to one based on adjusted gross income;
- a broadening of the definition of qualifying children to include descendants of stepchildren;
- the elimination of the one-year residency requirement for foster children, which is replaced with a six-month minimum requirement for all qualified children;
- the use of a new tie-breaking rule for cases in which a child is considered a qualifying child for more than one individual; and
- authority for the IRS to use a federal child support registry to reduce the number of erroneous EITC claims by ineligible non-custodial parents.

Effective Date: Taxable years beginning after December 31, 2001.

Fiscal Effect: +$1.90 GRP-Exp million in FY03 (to the extent that this increased credit is refunded to taxpayers, it may be financed by federal Temporary Assistance for Needy Family funds). This provision is automatically adopted for Wisconsin purposes, since the state credit is piggybacked on the federal credit.

16. Medical Savings Accounts

Federal Change: The CRTRA extends the Medical Savings Accounts (MSA) program through 2002 and renames these accounts "Archer MSAs." The MSA pilot program began in 1997 and was set to expire at the end of 2000. Prior to Congressional approval to expand the program, existing accounts could be maintained, but new accounts could not be established after December 31, 2000.

The program is limited to the self-employed and employees of small employers (i.e., firms with 50 or fewer employees). For existing firms, the number of employees is the average number of employees over the previous two calendar years; for start-up firms, it is the average number of employees expected during the current year. Participating firms that grow beyond 50 employees may continue to enroll MSA participants until they have 200 employees; at that point, they may only maintain existing accounts. Further, the program is limited to 750,000 participants nationwide.

Participation in an MSA requires simultaneous enrollment in a high deductible health plan. For individuals, the deductible must range from $1,550 to $2,350 and the maximum out-of-pocket limitation is $3,050. For families, the deductible must range from $3,100 to $4,650 and the maximum out-of-pocket limitation is $5,700.

Employer contributions to an MSA are excluded from gross income and contributions by an individual may be deducted from income. Contributions to an MSA are capped at 65% of the health insurance deductible for individuals and 75% of the deductible for family coverage. Although the limits on MSA contributions are based on the annual deductible amount, payments into a plan are restricted on a monthly basis and are calculated as 1/12 of the annual contribution limit. Employer contributions through a "cafeteria plan" do not qualify for the exclusion.

Distributions from an MSA are excluded from income if they are expended for qualified medical expenses, including any unreimbursed medical costs for the benefit of an eligible

MSA participant, his or her spouse and any dependent. Insurance may not be purchased with funds from an MSA, with the exception of long-term care insurance. Distributions used for purposes other than eligible expenses are subject to a 15% penalty unless the participant is 65 years or older.

Effective Date: Taxable years beginning after December 31, 2000.

Fiscal Effect: Minimal revenue loss.

17. Tax Benefits with Respect to Kidnapped Children

Federal Change: The CRTRA clarifies that a taxfiler may claim dependency status for his or her child if law enforcement authorities presume that child has been kidnapped by someone who is not a family member. This treatment continues for all tax years during the period that the child is kidnapped. Treatment ends either in the taxable year ending after the calendar year in which it is determined that the child is dead or in the taxable year ending after the calendar year in which the child would have attained the age of 18.

If adopted, this provision would affect filing status determination, claims for personal exemptions and eligibility for the earned income tax credit (EITC) under state law.

Effective Date: Taxable years ending after December 21, 2000.

Fiscal Effect: Minimal.

18. IRAs for Nonworking Spouses

Federal Change: The CRTRA limits IRA contributions for the lesser-earning spouse to the combined earned income of both spouses. IRA contributions are generally limited by the individual's earned income. However, a spouse with little or no earnings may claim an IRA deduction if the other spouse has earnings in excess of his or her own IRA deduction. This change ensures that couples with a nonworking or lesser-earning spouse cannot make contributions in excess of the couple's combined earned income.

Effective Date: Taxable years beginning after December 31, 1996.

Fiscal Effect: Minimal. The number of taxfilers that have been taking advantage of the loophole in prior law is presumed to be small.

B. CORPORATE AND OTHER BUSINESS INCOME TAX PROVISIONS

1. Renewal Communities

Federal Change: The CRTRA authorizes the secretary of Housing and Urban Development to designate up to 40 renewal communities from state and local government nominations; 12 communities must be in rural areas. Nominated areas are ranked based on a formula that considers median income, poverty rates and unemployment rates. State agencies may allocate tax benefits beginning in 2002.

Taxpayers in designated areas are eligible for a commercial revitalization deduction equal to either 50% of qualifying expenditures for a taxable year in which a qualified building was placed in service, or all of the qualifying expenditures prorated over a 10–year period. Qualified property is also eligible for an additional $35,000 of section 179

expensing. Under section 179, qualified businesses may elect to expense certain depreciable business assets in the year acquired.

Effective Date: The 40 renewal communities must be designated by January 1, 2002. Tax deductions are available from January 1, 2002 through December 31, 2009.

Fiscal Effect: Minimal.

2. Empowerment Zones

Federal Change: The CRTRA extends empowerment zone designation through December 31, 2009, and authorizes designation of nine more zones by 2002. An additional $35,000 of section 179 expensing is available for qualified property placed in service in a zone beginning in 2002. Under current federal law, an additional $20,000 of property placed in service in an empowerment zone may be expensed in one year under section 179 rather than being depreciated over several years.

Effective Date: The additional nine zones must be designated by January 1, 2002. Additional tax deductions are available for existing and new from January 1, 2002 through December 31, 2009.

Fiscal Effect: Minimal.

3. Environmental Remediation Costs

Federal Change: The CRTRA extends the expiration date for an election to deduct certain environmental remediation expenditures that would otherwise be charged to a capital account to include expenses paid or incurred before 2004. The requirement that expenditures be in a targeted area is eliminated so that most other sites certified by state environmental agencies as containing hazardous substances are eligible.

Effective Date: Expenditures after December 21, 2000.

Fiscal Effect: -$1.25 million in FY03.

4. Corporate Donations of Computer Technology

Federal Change: The CRTRA extends the expiration date for deductions of certain computer equipment donated to elementary and secondary schools through 2003. The deduction is extended to include donations to public libraries, donations of property up to three years after acquisition, rather than two years under prior law, and donations of property reacquired by a computer manufacturer.

Effective Date: Donations made after December 31, 2000.

Fiscal Effect: -$1.10 million in FY03.

5. Duplication or Acceleration of Loss Through Assumption of Certain Liabilities

Federal Change: The CRTRA requires that the basis of stock received in certain tax-free exchanges be reduced by the amount of any liability assumed in exchange for the stock that does not otherwise reduce the transferor's basis. Stock cannot be reduced below its fair market value. The provision would generally not apply if the trade or business with

the liability or substantially all of the assets associated with the liability is transferred to the corporation in the exchange.

Effective Date: Assumptions of liabilities on or after October 19, 1999.

Fiscal Effect: +$0.20 million in FY03.

6. Securities Futures Contracts

Federal Change: The CRTRA specifies the tax treatment of securities futures contracts. A securities future contract is a sales contract for future delivery of a single security or a narrow-based security index.

Except in the case of a securities futures contract dealer, gain or loss from the sale or exchange of a securities future contract is treated in the same manner as gain or loss of the underlying security. Any gain or loss from a short side sale of a securities futures contract is short-term capital gain or loss.

The act also applies wash sale rules, short sale rules and straddle rules to futures securities contracts. Under wash sale rules, loss generally is nondeductible if it occurs from a sale or disposition of a stock or securities that is substantially identical to stock or securities acquired within 30 days before or after the loss. Under short sale rules, certain gains or losses from sale or exchange of property are considered gains or losses of a capital asset if substantially identical property has been held for less than one year. Straddle rules limit losses in certain cases of offsetting positions wherein a taxpayer's risk of loss is substantially diminished because of other holdings.

The act also provides that dealer securities futures contracts will be treated as marked to market contracts. A marked to market contract is treated as 40% short-term and 60% long-term capital gain or loss. The secretary of the Treasury must determine who is to be treated as a dealer no later than July 1, 2001. Contracts must be securities futures contracts entered into in the normal course of business and traded on a qualified board or exchange.

Effective Date: December 21, 2000.

Fiscal Effect: Minimal.

7. Installment Method for Accrual Method Taxpayers

Federal Change: The ITCA retroactively repeals a provision enacted in the 1999 Ticket to Work and Work Incentive Improvements Act that would have disallowed the installment method of accounting for accrual method taxpayers. Under the installment method, taxpayers could defer recognition of income from the disposition of property until payments were received. The previously enacted change was repealed because it was viewed as especially harsh on sales of small businesses because it required taxpayers who sold the business on installments to report and pay capital gains tax on the total purchase price in the year of the sale.

Effective Date: December 17, 1999.

Fiscal Effect: Minimal.

8. Foreign Sales Corporations

Federal Change: The FSCRA repeals the present foreign sales corporation (FSC) rules and replaces them with an exclusion for extraterritorial income. The tax benefit under the exclusion is expected to mirror the tax benefit under the FSC rules, but apply to a greater number of taxpayers. Unlike the FSC rules, corporations can use the new benefit directly rather having to create specifically defined FSC subsidiaries. The act contains transition rules for current FSCs.

The law change is in response to a decision by the World Trade Organization (WTO) that the FSC provisions breach WTO rules by providing subsidies to assist U.S. exports, thus giving U.S. companies an unfair advantage in international trade. In August 2001, the WTO ruled that the new scheme still gives preferential treatment to American-made products. On January 14, the WTO rejected the U.S. appeal of that ruling. The WTO will decide by March 28 the compensation that the U.S. must give the European Union.

Effective Date: For transactions entered into after September 30, 2000. No corporation may elect to be a FSC after that date. Transition rules are included for current FSCs.

Fiscal Effect: -$2.80 million in FY03.

C. PENSION PROVISIONS

1. Increase in Contribution Limits

Federal Law Change: EGTRRA increases the dollars limited on defined contribution plans, elective deferrals and compensation limits, as follows:

For defined contribution plans, the base amount is increased to $40,000 from $35,000 in 2001 and this base is indexed for inflation, rounded down to the nearest $1,000. The base for indexing is the quarter beginning July 1, 2001.

For elective deferrals under sec. 401(k) plans, sec. 403(b) annuities and sec. 408(k) salary reduction simplified employee pension (SEP) plans, the maximum elective deferral is increased to $11,000 from $10,500 in 2001. The limit is increased by $1,000 annually thereafter until the limit reaches $15,000 in 2006. Thereafter, the limit is indexed annually for inflation, rounded down to the nearest $500, with the base for indexing being the quarter beginning July 1, 2001. The same limits are provided for deferrals under sec. 457 tax-exempt organization and state or local government plans, an increase from the current $8,500 in 2001, after indexing for inflation.

For elective deferrals under savings incentive match plan for employees (SIMPLE) plans, the limit is increased to $7,000 from $6,500 in 2001. The limit is increased by $1,000 each year until the limit reaches $10,000 in 2005. Thereafter, the limit is increased annually for inflation, rounded down to the nearest $500, with the base period being the calendar quarter beginning July 1, 2004.

The compensation limit for employer deduction rules, and for nondiscrimination testing purposes for section 408(k) salary reduction SEPs, section 501(c)(9) voluntary employee benefit associations (VEBA) and section 501(c)(17)(A) supplemental unemployment compensation benefit trusts (SUB) is increased to $200,000 from $170,000 in 2001. The limit in indexed for inflation, rounded down to the nearest $5,000, with the base period being the quarter beginning July 1, 2001.

Effective date: Years beginning after December 31, 2001.

Fiscal effect: -$0.40 million in FY02, -$1.50 million in FY03.

2. Benefit Limits under Qualified Plans

Federal Law Change: EGTRRA increases the annual benefit limit under defined benefit plans to $160,000 from $140,000 in 2001. This amount is indexed for inflation, rounded down to the nearest $5,000, with the base period for indexing the quarter beginning July 1, 2001. The law provides that the dollar limit is reduced if benefits begin before age 62 and increased if benefits begin after age 65, with special provisions for commercial airline pilots tied to Federal Aviation Administration rules. Under current law, the dollar limit is reduced if benefits begin before and increased if benefits begin after the social security retirement age, which is currently 65.

Effective date: Benefit plan years ending after December 31, 2001.

Fiscal effect: -$0.10 million in FY02, -$0.25 million in FY03.

3. Catch-up Contributions

Federal Law Change: EGTRRA increases the dollar limits on elective deferrals under several types of plans for persons age 50 or older before the end of the plan year. The additional amount of elective contribution equals the lesser of the applicable dollar amount, which varies by type of plan, or the participant's compensation for the year, less any other elective deferrals he or she has made.

The applicable amount for participants in sec. 401(k)(11) plans or SIMPLE plans is $500 in tax year 2002, $1,000 in 2003, $1,500 in 2004, $2,000 in 2005 and $2,500 in 2006. For participants in other plans, including other sec. 401(k) cash or deferred arrangement plans, tax-sheltered annuities, SEPs and state or local government plans, the applicable amount is $1,000 in 2002, $2,000 in 2003, $3,000 in 2004, $4,000 in 2005 and $5,000 in 2006. The amounts for 2006 are adjusted annually for inflation, rounded down to the nearest $500, with the base period being the quarter beginning July 1, 2005. For participants of a state or local government retirement plan, these limits do not apply in the last three years before retirement; instead, the regularly applicable dollar limit is doubled.

These catch-up contributions are not subject to other contribution limits or taken into consideration in the application to other contribution limits, and employers are permitted to make matching contributions. The contributions do not violate nondiscrimination rules if all participants eligible for all plans offered by the same employer are permitted to make the same election regarding catch-up contributions.

Effective Date: Contributions in tax years beginning after December 31, 2001.

Fiscal Effect: -$0.50 million in FY02, -$1.20 million in FY03.

4. Increases in Defined Contribution Plan Limit

Federal Law Change: The contribution limit is raised to 100% of compensation for defined contribution plans, tax-sheltered annuities and sec. 457 state and local government plans to make these limits consistent with those of other plans. Previous limits were 25% of compensation for defined contribution plans and 33-1/3% for sec. 457 plans. Tax-sheltered annuities were previously subject to an exclusion allowance

limitation equal to 20% of compensation multiplied by the employee's year of service, less any excludable contributions from prior years.

An alternative exclusion allowance for church plans is also repealed, which leaves the exception to the contribution limitation at the election of the participant, subject to an aggregate limitation for all special contributions.

Effective Date: Years beginning after December 31, 2001, except that the special contribution limits apply for years beginning after December 31, 1999.

Fiscal Effect: -$0.20 million in FY02, -$0.40 million in FY03.

5. Faster Vesting of Employer Matching Contributions

Federal Law Change: EGTRRA shortens the two alternative vesting schedules of a participant's nonforfeitable right in the employer's matching contributions. Under the first schedule, the period of time after which an employee is 100% vested is reduced from five to three years. Under the second schedule, an employee becomes 20% vested after the second, rather than the third year, and is fully vested after six, rather than seven years.

Effective Date: Plan years beginning after December 31, 2001, except for plans maintained under a collective bargaining agreement. For plans under collective bargaining agreements ratified by June 7, 2001, the provisions apply on the date the agreement terminates, but no earlier than January 1, 2002, and no later than January 1, 2006.

Fiscal Effect: Minimal.

6. Repeal of the Coordination Requirements for Section 457 Plan Limits

Federal Law Change: EGTRRA eliminates the requirement that participants in sec. 457 state and local government or tax-exempt organization plans coordinate the maximum annual deferral amounts for those plans with contributions made to other types of retirement plans. Previous law required a dollar-for-dollar reduction of the sec. 457 maximum annual deferral amount for deferrals or contributions to other retirement plans.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: -$0.05 million in FY02, -$0.15 million in FY03.

7. Repeal of Multiple Use Test for Section 401(k) Plans

Federal Law Change: Sec. 401(k) plans may not discriminate in favor of highly compensated employees, and are subject to several tests under federal law to ensure that such discrimination does not occur. EGTRRA repeals the multiple use restrictions that required plan providing elective deferrals and either after-tax employee contributions or employer matching contributions to satisfy several tests comparing deferrals and contributions for highly compensated and other employees.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: None (included in fiscal effect of other provisions).

8. Contributions by Self-Employed Members of Certain Religious Faiths

Federal Law Change: EGTRRA defines compensation for purposes of retirement plans, individual retirement arrangements and SIMPLE plans to include net earnings from self-employment to include earnings not subject to self-employment tax because of a religious exemption. This allows persons not subject to self-employment tax for religious reasons to establish or participate in such retirement plans.

Effective Date: Tax years beginning after December 31, 2001.

Fiscal Effect: None (included in fiscal effect of other provisions).

9. Increase in Employer Deduction Limits

Federal Law Change: EGTRRA increases the amount of deductible contributions employers may make to retirement plans. For defined contribution and simplified employee pension plans, the limit is increased from 15% to 25% of compensation. For money purchase plans, the deduction is the greater of 25% of compensation or the amount the employer is required to contributed under sec. 401(k)(11).

In addition, the definition of compensation for purposes of deductible contribution limits is expanded to include:

- wages that a permanently and totally disabled person would have received if paid at the same rate he or she was receiving prior to the disability;
- elective deferrals to 401(k), SEP, 403(b) annuity and SIMPLE plans; and
- amounts contributed or deferred with respect to a cafeteria plan, transportation fringe benefit plan, or state or local government or tax-exempt organization deferred compensation plan.

This new definition of compensation applies for stock bonus plans, profit-sharing plans, plans that consist of a combination of defined contribution and defined benefit plans, plans for self-employed individuals, and employee stock ownership plans.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal in FY02, -$0.10 in FY03.

10. Exclusion of Elective Deferrals in Determination of Deduction Limits

Federal Law Change: EGTRRA provides that certain elective deferral contributions are no longer deemed employer contributions and thus not subject to the limitations on employer deductions. Contributions affected are salary reduction contributions to a cash or deferred arrangement under a sec. 401(k) plan, to a salary reduction simplified employee pension (SARSEP), to a tax-sheltered annuity plan or to a SIMPLE account.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: -$0.20 million in FY02, -$0.40 million in FY03.

11. Application of Deduction Rules to Defined Benefit Plans

Federal Law Change: EGTRRA extends the deduction for amounts contributed of up to 100% of a plan's unfunded current liability to all defined benefit pension plans. Previously, the deduction had not been permitted for multiemployer plans and plans with

100 or fewer participants. For plans with 100 or fewer participants, the unfunded current liability does not include liability attributable to benefit increases for highly compensation employees within the last two years. The act also provides that the deductible contribution in the year the plan terminates is the amount required to make the plan sufficient for benefit liabilities.

Effective Date: Plan years beginning after December 31, 2001.

Fiscal Effect: Minimal.

12. Treatment of Contributions to a Multiemployer Plan

Federal Law Change: EGTRRA clarifies that an employer's determination as to whether a contribution to a multiemployer plan is on account of prior year is not a method of accounting, and thus the decision to begin deducting contributions is not a change in accounting method subject to an adjustment in the employer's taxable income.

Effective Date: Years ending after June 7, 2001.

Fiscal Effect: None in FY02, -$0.05 million in FY03.

13. Treatment of Elective Deferrals as Roth Contributions

Federal Law Change: EGTRRA permits sec. 401(k) and 403(b) plans to provide a Roth contribution program, in which participants may elect to have all or a portion of their elective deferrals designated as after-tax contributions. Earnings and distributions from accounts under such a program would be tax-free, as under Roth IRAs.

An employee may elect to designate all or a part of the elective deferrals he or she is eligible to make as a Roth contribution. Whereas the elective deferral would have been excluded from income and distributions from the pension or annuity plan would have been tax, the designated Roth contribution is included in the employee's income and thus subject to tax, but distributions are tax-free. Roth contributions are fully and immediately vested, since they are treated as elective deferrals.

The limit on elective deferrals applies to the total of pre-tax elective deferrals and after-tax Roth contributions. Roth contributions that exceed the limit and earnings allocable to them must be returned to the taxpayer by April 15 of the year following the year the excess deferral was made. If they are not returned, excess deferrals are included in income in both the year of deferral and the year the excess deferral and earnings are distributed—thus, subject to tax twice.

Distributions from a designated Roth account may be rolled over only to another designated Roth account maintained for the individual or to a Roth IRA in which the individual participates. Rollovers are not considered in applying the annual limit on designated Roth contributions.

Roth contributions are subject to the distribution restrictions similar to those for Roth IRAs. Distributions may not be made, without penalty, until the participant reaches age 59-1/2, dies or becomes disabled. In addition, a distribution is subject to penalty if it is made within five years of the first tax year in which a designated contribution was made.

When a participant makes a rollover contribution to a designated Roth account from a previously established Roth account, the five-year period begins the tax year of the first contribution to the previously established account.

The contributions are treated as elective deferrals for purposes of determining whether the plan discriminates in favor of highly compensated employees. Employers must establish a separate designated Roth account for each participating employee, and must report a participant's contributions on his or her Form W-2.

Effective Date: Tax years beginning after December 31, 2005.

Fiscal Effect: None in the current biennium.

14. Repeal of the 160% Current Liability Funding Limit

Federal Law Change: Federal law provides minimum and full-funding limits to ensure that defined benefit pension plans are adequately funded. The full-funding limit was the excess of the accrued liability of the plan, but not more than the applicable percentage of the plan's current liability, over the value of the plan's assets. EGTRRA raises the applicable percentage of the plan's current liability to 165% in 2002 and 170% in 2003, then repeals the provision relating to the applicable percentage for 2004 and thereafter. Previously, the applicable percentage was 160% in 2002, 165% in 2003 and 2004, and 170% and thereafter.

With repeal of the applicable percentage provision, the full-funding limit will be the excess of the plan's accrued liability over the value of the plan's assets.

Effective Date: Plan years beginning after December 31, 2001.

Fiscal Effect: -$0.05 million in FY02, -$0.10 million in FY03.

15. Modification of Benefit Limits for Multiemployer Plans

Federal Law Change: EGTRRA repeals the 100% of compensation rule that limits benefits on behalf of a participant in a multiemployer defined benefit plan. Under previous law, benefits were limited on an annual basis to an annual dollars amount ($140,000 in 2001) that is adjusted for inflation, but not more than 100% of the participant's average compensation for the three highest paid years. With repeal of the 100% of compensation rule, benefits are limited to the inflation-adjusted annual dollar amount.

The act also provides that the 100% of compensation limit will not apply to participants of specified collective bargained defined plans other than multiemployer plans. Further, it provides that multiemployer plans will not be aggregated with non-multiemployer plans for purposes of applying the 100% of compensation limit to non-multiemployer plans or with any other multiemployer for purposes of determining benefit and contribution limits.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal.

16. Modification of Timing of Plan Valuations

Federal Law Change: EGTRRA allows, under limited circumstances, the annual valuation of plan assets to occur in the immediately preceding year. Proposed Internal Revenue Service (IRS) regulations would have required asset valuations during the plan year or within the month prior to the beginning of that year. The act continues the requirement for annual valuation of plan assets and creates as a general rule that valuation occur within the plan year or the month prior to the start of that year. However, it also allows plan assets to be valued on any date within the prior plan year, as long as the value of the plan assets are not less than 125% of the plan's current liability. Further, actuarial adjustment are required to reflect significant differences between participants in the prior and current years.

Effective Date: Plan years beginning after December 31, 2001.

Fiscal Effect: Minimal.

17. Investment of Employee Contributions in 401(k) Plans

Federal Law Change: EGTRRA amends the effective date of provisions of the Taxpayer Relief Act of 1997 relating to elective deferrals so that these provisions do not apply to deferrals invested in assets consisting of securities or real property of the employer. The previous effective date had the unintended effect of requiring plans to maintain separate accounts for deferrals invested on or before December 31, 1995, and for deferrals invested after that date. This change eliminates the need for separate accounts.

Effective Date: Elective deferrals for plan years beginning after December 31, 1998.

Fiscal Effect: Minimal.

18. Minimum Distribution Rules

Federal Law Change: EGTRRA directs the IRS to modify life expectancy tables to reflect current life expectancy in its minimum distribution rules for qualified plans, annuities and IRAs. The agency had not revised life expectancy tables in regulations, proposed earlier this year, that are intended to replace 1987 rules in 2002.

Effective Date: June 7, 2001.

Fiscal Effect: Minimal.

19. Treatment of Section 457 Distributions under a Divorce Decree

Federal Law Change: EGTRRA permits early distributions from a deferred compensation plan of a state or local government or tax-exempt organization based on a qualified domestic relations order. The distribution must be made pursuant to a domestic relations order under a state domestic relations law in regards to child support, alimony payments or marital property rights. Further, the order must create or recognize the rights to plan benefits of an alternate payee or assign such rights to that payee.

Effective Date: Transfers, distributions and payments made after December 31, 2001.

Fiscal Effect: Minimal

20. Hardship Withdrawals from Section 401(k) Plans

Federal Law Change: EGTRRA directs the IRS reduce from 12 months to six months the period during which an employee is prohibited from making elective contributions and after-tax contributions to a sec. 401(k) or 403(b) plan following a hardship withdrawal. The restriction is contained in safe harbor regulations governing hardship withdrawals.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal.

21. Elimination of "Same Desk" Rule

Federal Law Change: EGTRRA eliminates the "same desk" rule for distributions from sec. 401(k) and 457 plans and sec. 403(b) tax-sheltered annuities. Under this rule, employees who continue on the same job for a different employer following the liquidation, merger or consolidation of the former employer were not considered as separated from service. This required the previous employer to retain terminated employees in its plan, even though they continued to work for the purchasing employer. Under the act, these employees will be permitted to receive distributions from the plan or annuity of the previous employer.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: Minimal.

22. Purchase of Service Credit under a Governmental Plan

Federal Law Change: Under EGTRRA, a taxpayer is not required to include in gross income a trustee-to-trustee transfer of amounts from a sec. 403(b) annuity or sec. 457 plan to a governmental defined plan for the purchase of permissive credits or for repaying previous cash-outs. A permissive credit is credit for a period of service recognized by a governmental plan; a cash-out refers to the forfeiture of previous service credit.

Effective Date: Transfers after December 31, 2001.

Fiscal Effect: Minimal

23. Rollovers Disregarded as Cash-out Amounts

Federal Law Change: EGTRRA permits the disregard of plan value attributable to rollovers in determining whether a plan may involuntarily cash out a participant. A plan may cash out a participant whose employment the plan sponsor has terminated if the present value of the participant's benefits does not exceed $5,000. Under the act, this present value may be calculated without including any portion attributable to rollover contributions, and earnings on those contributions, from an IRA, a plan sponsored by a previous employer or other source. The act also provides that state and local government, and tax-exempt organization plans may disregard rollovers in determining a participant's nonforfeitable plan benefit for purposes of the cash-out rule.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: Minimal.

24. Automatic Rollover of Certain Mandatory Cash-Out Distributions

Federal Law Change: EGTRRA makes direct rollover the default option for involuntary cash-out distributions that exceed $1,000. The distribution is automatically rolled over to a designated IRA unless the participant elects to have the distribution transferred to a different IRA or qualified plan, or to receive it directly.

The act requires the secretary of labor to issue regulations, by June 7, 2004, indicating safe harbors under which designation of an institution and investment of funds in accord with the automatic rollover provision satisfies federal law regarding the fiduciary responsibilities of retirement plans.

Effective Date: Distributions made after the secretary of labor issues final regulations implementing the safe harbor provisions.

Fiscal Effect: None in current biennium.

25. Minimum Distribution and Inclusion Rules for Section 457 Plans

Federal Law Change: EGTRRA repeals the special minimum distribution rules that had applied only to deferred compensation plans sponsored by state and local governments and tax-exempt organizations. As a result, these plans are subject only to minimum distribution rules governing qualified plans generally.

In addition, amounts deferred under a governmental plan are includible in the taxpayer's income only when paid, and not when otherwise made available to the taxpayer. This change does not apply to participants in tax-exempt organization plans; amount deferred are included in income when paid or otherwise made available.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: None (included in fiscal effect of other provisions).

26. Plan Loans for Small Business Owners

Federal Law Change: EGTRRA expands the types of owner-employees eligible for an exemption from rules prohibiting loans between a qualified plans and a disqualified person. Under the act, the exemption from these rules is extended to sole proprietors, to partners owning more than 10% of the capital interest or profits interest in a partnership, and to employees or officers of an S corporation who own more than 5% of the corporation's outstanding stock.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: -$0.10 million in FY02, -$0.15 million in FY03.

27. Optional Forms of Benefits

Federal Law Change: EGTRRA cuts back on the forms of distributions a defined contribution plan is required to provide in order not to be treated as reducing accrued benefits. Fewer forms of distribution may be provided if five conditions are met:

- the plan received from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan;
- the terms of both the transferor and transferee plans authorize the transfers;
- the transfer result from a voluntary election by the participant or beneficiary whose account is being transferred;
- this election is made after the participant or beneficiary receives notice of the consequences of the election; and
- the transferee plan allows the participant or beneficiary to receive and distribution of benefit as a lump sum.

The act further provides that, if a plan eliminates a previously available form of distribution, a single-sum distribution, based on the same or greater portion of the participant's account as the form of distribution being eliminated, must be available at the same time that the form is being eliminated.

The act directs the IRS to issue regulations no later than December 31, 2003, allowing plan amendments that reduce or eliminate early retirement benefits, retirement-type subsidies and optional forms of benefits, so long as any adverse effect of such amendments on the rights of participants is not substantive. Factors to be considered in determining whether an adverse effect is substantive include:

- the benefits being reduced or eliminated by the amendment;
- the extent to which benefits available after the amendment takes effect provide rights comparable to the rights reduced or eliminated;
- the number of years before the participant reaches normal retirement age or any applicable early retirement age under the plan;
- the amount of the participant's benefit affected by the plan amendment in relation to the participant's compensation; and
- the number of years before the plan amendment is effective.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal.

28. Rollovers to and from Governmental Plans and Tax-Sheltered Annuities

Federal Law Change: EGTRRA allows an employee participating in a sec. 457 governmental deferred compensation plan to roll over, tax-free, a distribution to plans to which tax-free rollovers were previously not permitted. These include another governmental plan, an IRA, a 401(k) or other qualified plan or a tax-sheltered annuity. In addition, the act permits tax-free rollovers from a qualified plan, IRA or tax-sheltered annuity to a government plan; previously these rollovers were not tax-free. The act also permits tax-free rollover of distributions from a tax-sheltered annuity to a 401(k) or governmental plan, and of distributions from a qualified plan, an IRA or governmental plan to a tax-sheltered annuity. Previously, such rollovers were not tax-free.

Eligible rollover distributions from governmental deferred compensation plans include any distribution of any portion of the balance in an employee's plan, excluding required distributions and periodic payments made over the employee's or another specified period of 10 years or more. In addition, hardship distributions are not eligible for rollover. The amount eligible for rollover is the amount of distribution that would be included in income; thus, after-tax contributions cannot be rolled over. Amounts rolled over to a governmental plan are not considered in determining the maximum amount an employee may defer.

Under the act, capital gain and averaging treatment will not be available for distributions from a governmental plan or tax-sheltered annuity to which a rollover contribution has been made under the provisions of the act.

Rollovers to and from government plans and tax-sheltered annuities are subject to the same restrictions and guidelines applying to rollovers from IRAs and qualified plans. The act also makes the direct trustee-to-trustee rollover option available to governmental plans.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: +$0.10 million in FY02, minimal in FY03.

29. Expansion of Spousal Rollover Rules

Federal Law Change: EGTRRA permits the surviving spouse of a deceased participant in a qualified plan to make a tax-free rollover of an eligible rollover distribution from the plan to another qualified plan, a tax-sheltered annuity or a governmental plan in which the surviving spouse participates. Previously, a tax-free rollover was permitted only to an IRA.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: Minimal.

30. Rollovers from IRAs to Employer Plans

Federal Law Change: EGTRRA permits a tax-free rollover of an eligible distribution from an IRA to a qualified employer plan, tax-sheltered annuity or governmental or tax-exempt organization deferred compensation plan. Previously, such rollovers were limited to rollovers from conduit IRA—an IRA whose value is attributable solely to a previous rollover from another qualified plan. One rollover of an IRA distribution to an employer plan is permitted per year.

The eligible rollover distribution is generally the amount of a distribution from an IRA includible in gross income; distributions of after-tax contributions may be rolled over to another IRA, but not to an employer plan. In addition, required minimum distributions from IRAs and distributions from inherited IRAs to beneficiaries other than a spouse may not be rolled. Capital gains and averaging treatment will not be available for distributions from a qualified plan to which an IRA rollover contribution has been made under the provisions of the Act.

A distribution from a SIMPLE IRA is treated like a traditional IRA distribution after the employee has participated in the SIMPLE plan for two years. Otherwise, a distribution from a SIMPLE IRA can be rolled over only to another SIMPLE plan.

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: Minimal.

31. Rollover of After-Tax Contributions

Federal Law Change: EGTRRA permits a tax-free rollover of the entire amount of a distribution from one qualified plan into another qualified plan or individual retirement account. This includes the portion of the distribution representing after-tax contributions, which, under previous law, were included in gross income when the distribution was made. A rollover of after-tax contributions may be made only through a direct trustee-to-trustee transfer. A qualified plan accepting after-tax contributions must separately track those contributions and any related earnings. IRAs are not required to separately track after-tax contributions.

Under the act, a distribution from a traditional IRA that is rolled over to a qualified plan other than an IRA is considered to derive first from amounts in an employee's combined IRA accounts other than after-tax contributions, and only then from after-tax contributions.

Effective Date: Distributions made after December 31, 2001.

Fiscal Effect: Minimal.

32. Hardship Exception to 60-Day Rule

Federal Law Change: Federal law requires a tax-free rollover of a distribution from a qualified plan or IRA to occur within 60 days, and permits no exceptions for hardship. EGTRRA permits the IRS to waive the 60-day rollover period for hardship reasons.

Effective Date: Distributions made after December 31, 2001.

Fiscal Effect: Minimal.

33. Hardship Distributions Ineligible for Rollover

Federal Law Change: EGTRAA stipulates that any hardship distributions of elective deferrals made under a sec. 401(k) or 403(b) plans is not an eligible rollover distribution. As a result, these hardship withdrawals are not subject to the 20% withholding tax generally imposed on eligible rollover distributions that are not directly rolled over to another plan or IRA. Hardship distributions that may not be rolled over remain subject to withholding and to the 10% penalty tax on early distributions

Effective Date: Distributions after December 31, 2001.

Fiscal Effect: Minimal.

34. Reinvestment of ESOP Dividends

Federal Law Change: EGTRRA allows corporations to deduct, at the election of plan participants or their beneficiaries, dividends paid to an employee stock ownership plan (ESOP) and reinvested in qualified employer securities. This expands the deduction

previously allowed to dividends that an employee would voluntarily reinvest back into the ESOP for more of the employer's stock. However, the act expands IRS authority to disallow deductions claimed for the purpose of avoiding or evading tax.

Effective Date: Tax years beginning after December 31, 2001.

Fiscal Effect: -$0.10 million in FY02, -$0.25 million in FY03.

35. Modification of Top-Heavy Rules

Federal Law Change: EGTRRA changes the definitions of top-heavy plan and key employee to reduce the number of plans that are deemed top heavy. It also adjusted minimum benefit or contribution rules for these plans. A plan is top heavy when more than 60% of the plan assets are in accounts attributed to key employees.

Under previous law, a top-heavy defined benefit plan was required to provide a minimum annual benefit to nonkey employees. This benefit was equal to the lesser of 2% of the employee's average annual compensation for a five-year testing period multiplied by the number of years of service, or 20% of the employee's average annual compensation for a five year testing period. A top-heavy defined contribution plan was required to provide a minimum annual contribution equal to the employee's compensation for the year multiplied by the lesser of 3% or the contribution rate for key employees.

In addition to these minimum benefit or minimum contribution requirements, a qualified cash or deferred arrangement under sec. 401(k) was required under previous law to satisfy the actual deferral percentage (ADP) nondiscrimination test for an employee's deferrals and a nondiscrimination test for employer's matching contributions.

EGTRRA excludes from the definition of a top-heavy plan any cash or deferred arrangement meeting the ADP nondiscrimination test and the nondiscrimination test for matching contributions. When a plan deemed not top heavy under this rule belong so an aggregation group of plans that is top heavy, its contributions may be taken into account in determining whether any other plan in the group meets minimum distribution requirements.

The act also provides that, for determining whether 60% of the plan assets are in accounts of key employees, the accrued benefit or account balance for any participant is increased for distributions made to the participant during the year ending on the determination date. Under previous law, distributions in the five previous years were taken into account. The act retains the five-year look-back period for distributions for reasons other than separation from service, death or disability. The five-year look-back period has also been reduced to one year for former employees. When an individual as not performed services for the employer during the year ending on the determination date, the accrued benefit for the individual is not taken into account in calculating the minimum accrued benefit.

EGTRRA defines a key employee to be an officer with compensation in excess of $130,000, a 5% owner or a 1% owner with compensation exceeding $150,000. Key employee status is determined looking at the past year only rather than the past year or any of the four preceding years, which was the look-back period under previous law. The act also eliminates from the definition of key employees the ten owner-employees with the largest annual compensation in excess of the defined contribution plan dollar limit ($35,000 in 2001) and with the largest ownership interests in the employer.

Under the act, employer matching contributions are taken into account in determining whether the minimum benefit requirement is satisfied for a defined contribution plan. For defined benefit plans, a frozen year, that is, a year in which no key employee or former key employee benefits under the plan, is not considered in determining the employee's years of service.

Effective Date: Years beginning after December 31, 2001.

Fiscal Effect: Minimal in FY02, - $0.05 million in FY03.

36. Nonresident Aliens Engaged in International Transportation

Federal Law Change: Under federal law, compensation for services performed by a nonresident alien in connection with the individual's temporary presence in the U.S. as a crew member on a foreign vessel is not U.S. source income. EGTRRA applies this rule for purposes of qualified retirement plans, employer-provided group-term life insurance and employer-provided accident and health plans. Under previous law, inclusion of the income of nonresident alien crew members for retirement plan purposes limited the ability of ship owners to provide retirement plans to their employees.

Effective Date: Remuneration for services performed in plan years beginning after December 31, 2001.

Fiscal Effect: Minimal.

37. Revision of Coverage Rules for Employees of Tax-Exempt Entities

Federal Law Change: EGTRRA directs the IRS to modify regulations so that tax-exempt charitable organizations may treat employees eligible to make contributions to a tax-sheltered annuity as excludable with respect to a sec. 401(k) cash or deferred arrangement or sec. 401(m) plan. This treatment is permitted only if no employee of the tax-exempt organization is eligible to participate in the sec. 401(k) or 401(m) arrangement and if 95% of the employees who are not employees of the tax-exempt entity are eligible to participate in those arrangements. Congress failed to make this change in the Small Business Job Protection Act of 1996 when it repealed the prohibition against maintenance of cash or deferred arrangements by tax-exempt entities.

Effective Date: Years beginning after December 31, 1996 (the effective date for related provisions in the Small Business Job Protection Act).

Fiscal Effect: Minimal.

38. Repeal of Special Definition of Highly Compensated Employee

Federal Law Change: EGTRRA repeals a special transitional rule enacted in the Tax Reform Act of 1986 in light of the simplified definition of highly compensated employee in the Small Business Job Protection Act of 1996.

Effective Date: Plan years beginning after December 31, 2001.

Fiscal Effect: Minimal.

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AGENCY: General Fund Taxes

LFB PAPER #: 1151

ISSUE: Earned Income Tax Credit – Use of Additional TANF Funds

ALTERNATIVE: 1

SUMMARY:

Alternative 1 uses TANF to support changes the state will make to the EITC as a result of changes to the federal law.

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March 4, 2002 Joint Committee on Finance Paper #1151

Earned Income Tax Credit -- Use of Additional TANF Funds (General Fund Taxes)

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. 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. Both the federal and state credits are refundable. If the credit exceeds the amount of income tax due, a check is issued for the difference.

Unlike most individual income tax provisions, the state EITC is automatically updated for federal law changes. Under the federal Economic Growth and Tax Relief Reconciliation Act of 2001, the federal credit was simplified and expanded for tax years starting after December 31, 2001. Among the changes was an increase in the thresholds for the credit phase-out income ranges for married couples filing joint returns over those that apply for single filers, which was intended to reduce the marriage penalty on married EITC claimants.

The state EITC is paid from two sources: (a) a sum sufficient, GPR appropriation; and (b) federal temporary assistance for needy families (TANF) block grant funding transferred from the Department of Workforce Development (DWD) to pay the portion of the EITC refunded to individuals who are eligible for TANF. [The TANF funding is budgeted as FED in DWD and as PR-S under Shared Revenue and Tax Relief.] The TANF portion is based on the assumption that approximately 80% of EITC payments will be refunded to TANF-eligible individuals.

Under 2001 Wisconsin Act 16 (the 2001-03 biennial budget), total EITC expenditures were estimated at $63,500,000 in 2001-02 ($12,255,500 GPR and $51,244,500 PR) and $64,700,000 in 2002-03 ($12,500,000 GPR and $52,200,000 PR). Based on the changes in federal law described above, total EITC expenditures for 2002-03 were reestimated in January, 2002, at $68,400,000 ($16,200,000 GPR and $52,200,000 PR), which is $3,700,000 more than the total figure under Act 16.

GOVERNOR

No provision.

DISCUSSION POINTS

1. The refundable portion of the state EITC is an eligible expenditure under the TANF block grant. An estimated 80% of the additional $3,700,000 provided for the EITC for 2002-03 is eligible to be funded by TANF. However, because the TANF funding is provided through an annual, sum-certain appropriation, any change in TANF funding for the EITC would require legislative action. As a result, the January, 2002, estimate of $3,700,000 in increased cost in 2002-03 was reflected entirely in the sum sufficient GPR appropriation.

2. There is projected to be sufficient TANF funding to cover the eligible portion of the increase in the estimated EITC costs as discussed below. Therefore, an option would be to increase the TANF funding for the EITC by $2,960,000, which is 80% of the $3,700,000 increase, and to decrease the GPR appropriation by the same amount.

3. The amount of TANF funding available in 2001-03 is estimated at approximately $43.09 million, as shown in Table 1. This includes: (a) unappropriated TANF funds; (b) funds placed in unallotted reserve in Act 16; (c) a contingency fund for W-2 cash benefits created in Act 16; and (d) a contingency fund for W-2 cash benefits in the Joint Committee on Finance's federal program supplements appropriation.

TABLE 1

Projected TANF Funds Available in 2001-03
(In Millions)

Unappropriated TANF Funds	$17.44
Unallotted Reserve	0.65
Contingency Fund Created by Act 16	10.00
Contingency Fund in Joint Finance Appropriation	15.00
Total	$43.09

4. The amount of TANF funds that are unappropriated and in unallotted reserve was last reported to the Committee on December 17, 2001, to be $4.87 million. Under current projections, these two revenue sources total $18.09 million. Changes include: (a) the Governor's budget reform bill would transfer $0.17 million GPR from the TANF program to DHFS to be used for community aids; (b) DWD determined that 2000-01 direct child care expenditures were overstated by $6.54 million; (c) DWD was awarded $1.93 million in additional federal child care revenues in the federal fiscal year 2002 budget; and (d) DWD has determined that it has sufficient eligible matching expenditures to draw down an additional $4.93 million in federal child care matching funds. In addition to the amounts shown in Table 1, there may also be savings in various TANF programs during the biennium. For example, the Badger Challenge program has been discontinued due to implementation of the 5% cuts mandated in Act 16, which will result in TANF program savings of $93,400. There may also be savings identified in April, 2002, from contracts that ended in December, 2001. In addition, DWD is currently reviewing direct child care expenditures for fiscal years 1997-98 through 1999-00 to determine the magnitude of any overstated expenditures, which will increase the amount of TANF funds available.

5. While TANF funding is available to cover a portion of the projected increase in the EITC, there are other demands on TANF funding that should be considered. The W-2 caseload has been rising since January, 2001. The cash benefit caseload has increased by 2,458 (37%) from January, 2001, to January, 2002, after being stable in calendar year 2000. The cash benefits caseload in January, 2002, was 9,137. However, based on average monthly expenditures per case in the last W-2 contract period, the funding in Act 16 for W-2 agency contracts starting on January 1, 2002, will only provide sufficient funding for an average of 7,862 cases per month. As shown in Table 1, two contingency funds totaling approximately $25 million have been created to address possible expenditure increases due to the rising caseload. This contingency funding would enable the state to support approximately 2,657 additional cases per month through June 30, 2003, for a total of 10,519 cases per month. Note that the final amount of the contingency fund created in Act 16 will not be known until community reinvestment expenditures are reconciled in April, 2002. Whether the funds set aside for caseload increases will be sufficient will depend on the length and severity of the current economic downturn and the speed of recovery. In addition to the W-2 caseload, the caretaker supplement program is currently projected to have an $8.4 million deficit in 2001-03.

6. Another factor to consider is the TANF structural deficit. Ongoing expenditures significantly exceed ongoing revenues in the TANF program. For the 2003-05 biennium, the structural deficit is estimated at $107 million annually. This estimate assumes that the amount of the state's TANF grant will not change when TANF is reauthorized at the federal level by September, 2002. Assuming no additional federal funds will be provided, the structural deficit will have to be addressed in the 2003-05 budget process by reducing program expenditures or providing additional state funding. Any available TANF funds not spent in 2001-03 would help mitigate this problem.

ALTERNATIVES TO BILL

1. Utilize TANF funding for the eligible portion of the projected increase in the cost of the EITC in 2002-03 by: (a) providing $2,960,000 in additional TANF funds in 2002-03; and (b) reducing estimated expenditures from the GPR sum sufficient EITC appropriation by $2,960,000 in that year. [The TANF funds would be budgeted as FED in DWD and also as PR-S under Shared Revenue and Tax Relief.]

Alternative 1	GPR	FED	PR	TOTAL
2001-03 FUNDING	- $2,960,000	$2,960,000	$2,960,000	$2,960,000

2. Maintain current law.

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