Wisconsin Department of Administration
Division of Executive Budget and Finance

Fiscal Estimate - 2003 Session

☒ Original ☐ Updated ☐ Corrected ☐ Supplemental

LRB Number **03-3266/3**	Introduction Number **SB-261**

Subject

Tax credit for new business venture; capital gains tax deferral and exlusion

Fiscal Effect

State:

☐ No State Fiscal Effect
☒ Indeterminate

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

Local:

☐ No Local Government Costs
☐ Indeterminate

1. ☐ Increase Costs ☐ Permissive ☐ Mandatory
2. ☐ Decrease Costs ☐ Permissive ☐ Mandatory
3. ☐ Increase Revenue ☐ Permissive ☐ Mandatory
4. ☐ Decrease Revenue ☐ Permissive ☐ Mandatory
5. Types of Local Government Units Affected
☐ Towns ☐ Village ☐ Cities
☐ Counties ☐ Others
☐ School Districts ☐ WTCS Districts

Fund Sources Affected

☒ GPR ☐ FED ☐ PRO ☐ PRS ☐ SEG ☐ SEGS

Affected Ch. 20 Appropriations

Agency/Prepared By	Authorized Signature	Date
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Fiscal Estimate Narratives

DOR 9/25/2003

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Subject Tax credit for new business venture; capital gains tax deferral and exlusion		

Assumptions Used in Arriving at Fiscal Estimate

Preliminary: Because of the limited time to review the draft, the estimate and analysis should be considered preliminary and may be revised.

The bill would create an income and franchise tax credit for certain investments in a qualified new business venture and provide an individual income tax deferral for capital gains from investments in qualified new business ventures and certain venture capital funds.

The Department of Commerce would certify businesses as qualified new business ventures for purposes of the credit and the capital gains deferral. A business must meet the following conditions to be certified:
□ Have its headquarters in the state.
□ Have at least 51% of its employees in the state.
□ Have average annual net income for each of the two taxable years before a credit is claimed that does not exceed $20 million.
□ Have net worth for the taxable year for which a credit is claimed that does not exceed $75 million.
□ Have been in operation in the state for at least three consecutive years, but not more than 10 years.
Further, the business cannot be engaged predominantly in certain occupations or industries, including:
□ providing professional services by accountants, lawyers or physicians
□ banking or lending or developing real estate for resale
□ making loans to or investments in certified capital companies
□ trade, leisure or hospitality industries

The Department of Commerce would create rules establishing a procedure for the department to certify venture capital funds for the purposes of the capital gains tax deferral. A venture capital fund could be certified only if it is a private seed and venture capital partnership or entity fund with its principal place of business in Wisconsin and if it commits to make equity investments in qualified new business ventures located in Wisconsin.

Capital Gains Tax Deferral

Under current law, 60% of long-term capital gains (gains realized on the sale of capital assets held for more than one year) is deducted from federal adjusted gross income (FAGI). A taxpayer may use up to $500 of net capital losses to offset ordinary income. Any amount of net capital losses over $500 may be carried forward to offset ordinary income in future years.

Effective taxable years beginning on January 1, 2006, this bill would allow a claimant to subtract from FAGI to the extent that the gains are not excluded from taxation under sec. 71.05 (6)(b)9., any amount of long-term capital gain, or gain realized from the sale of an asset, that is an investment in a qualified new business venture or a venture capital fund as certified by the Department of Commerce. This is essentially a deferral of income taxes on the gain realized from the sale of a qualifying asset. The claimant could be an individual, including an individual partner or member of a partnership, limited liability company, or limited liability partnership, or an individual shareholder of a tax-option corporation.

Following the sale of the asset, the claimant must immediately deposit the gain in a segregated account in a financial institution. The claimant must purchase another capital asset, which is an investment in a qualified new business venture or venture capital fund, within 90 days after the sale of the asset that generated the gain. The investment in this capital asset must be of equal or greater value to the amount of the gain generated by the sale of the original asset.

After purchasing the capital asset, the claimant must immediately notify the department that the claimant will not declare on the claimant's income tax return the capital gain because it has been reinvested in the prescribed manner as described in the prior paragraph.

The gain resulting from the sale of the original capital asset must be subtracted from the cost of the newly purchased asset to calculate the basis of the purchased capital asset. The gain resulting from the sale of the original capital asset may not be used to net capital gains and losses as described under sec. 71.05 (10)(c).

Income and Franchise Tax Credit

The bill would create an income and franchise tax credit that would equal 20% of the first $100,000 of investments in a qualified new business and 10% of investment amounts above $100,000. Taxpayers that are broker-dealers could claim a credit equal to 10% of the first $500,000 raised in an offering of a new business venture in a taxable year.

Investors could maximize their credit if married investors each invested in a business venture and received 20% of credit on $100,000, investors took $100,000 investments subject to the 20% credit in more than one business, and investors invested in the same business at 20% credit in more than one year. The estimate also assumes that offerings by broker-dealers are initial public offerings. If that is not the case, the fiscal effect could increase substantially because broker-dealers would get a 10% credit for many of the investment amounts that investors are also getting credits for.

Fiscal Effect

Data on the amount of investments in the state that would be subject to credit and capital gain deferral are not available. As a result, the department is unable to estimate the revenue loss attributable to the bill but expects that it would be very substantial. Based on Department data on type of industry, net income, net worth and company payroll, the provision could apply to as many as 50,000 existing businesses if they were certified by the Department of Commerce. Given the large number of businesses potentially eligible for certification, the revenue loss from this bill could be tens of millions of dollars annually, and potentially more. An estimate of the Department's cost to administer the bill are not available at this time.

Long-Range Fiscal Implications