STATE OF WISCONSIN

REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS

2003 SENATE BILL 261

[Introduced by Senators Kanavas, Stepp, Leibham, Darling, Brown, Welch, Zien, Lassa and Roessler, cosponsored by Representatives Nischke, McCormick, Ladwig, Musser, Montgomery, Towns, Owens, M. Lehman, Weber, Van Roy, Krawczyk, Olsen and Ott.]

General Nature of Proposal

In general, the bill creates an income and franchise tax credit for investments in a new business venture that has its headquarters and the majority of its employees in the state. The bill also directs the Department of Commerce, in cooperation with the Department of Financial Institutions and the University of Wisconsin System, to conduct and publish on an annual basis, results of a study of Wisconsin businesses to determine new business formation trends and to identify obstacles faced by new Wisconsin businesses and areas where changes in governmental policy might satisfy the needs of new Wisconsin businesses.

With respect to the provisions of the bill necessitating review by the Joint Survey Committee on Tax Exemptions, the bill modifies the current capital gains exclusion. Under current law, an income tax exclusion exists for individuals and tax option corporations for 60% of the net capital gains realized from the sale of assets held for at least one year, i.e., long-term capital gains. When certain business assets or assets used in farming are sold to family members or when qualifying small business stock is sold, long-term capital gains are completely excluded from taxation.

Under the bill, a claimant may elect to defer the payment of income taxes on the gain realized from the sale of a long-term asset, to the extent that the gain is not already excluded from taxation, or any asset that is an investment in a qualified new business venture or an investment in a venture capital fund, if the claimant completes a number of requirements. Under the bill, the claimant must place the gain from the original asset in a segregated account in a financial institution, purchase another capital asset that is an investment in a venture capital fund or in a qualified new business venture within 90 days after the sale of the original asset that generated the gain, and notify the Department of Revenue (DOR) on a form prepared by DOR that the claimant is deferring the payment of income tax on the gain from the original asset because the proceeds have been reinvested. The cost of the replacement asset must be equal to or greater than the gain generated by the sale of the original asset. The bill also specifies the basis of the replacement asset is the asset's cost minus the gain generated by the sale of the original asset. If a claimant defers the payment of income taxes on the gain generated by the sale of the original asset, the claimant may not use that gain to net the claimant's gains and losses as the claimant could do if the claimant did not elect to defer the payment of taxes on the gain.

The above-described capital gain deferral first applies to taxable years beginning January 1, 2006.

Legality Involved

There are no questions of legality involved.

Fiscal Effect Upon the State and Its Subdivisions

The DOR has described the fiscal effect of the provisions of the bill affecting tax exemptions, as follows:

> Capital Gains Tax Deferral
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> 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.
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> 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.
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> 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.
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> 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.
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> 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).

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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....

Public Policy Involved

The bill is good public policy if the provisions of the bill relating to capital gains deferrals, exclusions and exemptions are removed and if the tax credit provisions are narrowed.