Wisconsin Department of Administration
Division of Executive Budget and Finance

Fiscal Estimate - 2007 Session

☒ Original ☐ Updated ☐ Corrected ☐ Supplemental

LRB Number **07-3297/1**	Introduction Number **AB-0808**

Description
Creating a procedure for certain taxpayers to defer taxation on certain capital gains that are used to purchase a primary residence

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 11/5/2007

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Assumptions Used in Arriving at Fiscal Estimate

Under current Wisconsin law, individuals may exclude 60% of the gain realized from the sale of assets held more than one year when they calculate their income tax liabilities. Aditionally, under current federal law to which Wisconsin conforms, individuals may exclude up to $250,000 of capital gains ($500,000 for married taxpayers filing jointly) from the sale of their primary residence subject to certain use requirements.

Under this bill, an individual may elect to subtract the gain realized from the sale of an asset held more than one year if the claimant meets certain requirements. The requirements are: 1) immediately deposit the gain in a segregated account in a financial institution, 2) purchase a primary residential dwelling within 90 days, and 3) 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. The allowable percentage of the gain that may be subtracted for taxable year 2008 is 4%. The percentage increases by 4% per year until 2017 when 40% of the gain will be allowed to be subtracted.

Under the bill, the basis of the purchased primary residential dwelling would be calculated by subtracting the realized capital gain from the cost of the purchased dwelling. For example, under this bill in tax year 2008, if a single individual realized $100,000 of long-term capital gains in order to purchase a $500,000 primary residence, the claimant would be able to subtract $4,000 ($100,000 x 4%) of that gain for income tax purposes in addition to the current 60% exclusion. The individual's basis in the residence would be $400,000 ($500,000 - $100,000). If the individual later sold the property for $650,000 the calculated gain of $250,000 ($650,000 - $400,000) from the sale of the residence would be entirely excludable for income tax purposes. In this case, the $4,000 subtraction would not be a deferral since it would never be taxed. However, if the individual sold the residence for more than $650,000, he or she would be liable for income tax on the portion of the gain exceeding $250,000. In this case, the basis adjustment required at the time of the initial capital gain subtraction would create an additional tax liability at the time the residence is sold.

Gains realized from the sale of an asset that was obtained in a tax-free exchange of capital assets and sale of property purchased as a result of an involuntary conversion do not qualify for the subtraction under this bill. If a claimant subtracts a capital gain under this bill, the claimant may not use the gain to net capital gains and losses.

The extent to which taxpayers will take advantage of this subtraction is not known and the time horizon of the bill's phase-in period adds to the uncertainty in capital gain realization, so the revenue loss is inestimable. However, using the 2005 Individual Income Tax Sample, it is estimated that approximately $170 million of individual income tax liability was attributable to the non-excludable portion of long term capital gains in taxable year 2005. Of the total $170 million, $115 million was collected from individuals who paid property tax on a primary residence.

It is not known how many individuals used their long term capital gains to purchase a primary residence or the extent to which their taxable gains were less than the purchase price of their residences. For illustration purposes, if it is assumed that 10% of the homeowners used their long-term capital gains to purchase a primary residence in the taxable year and they were able to completely subtract those gains as a result of the bill, the fully phased-in cost of the bill would have been $11.5 million annually in 2005 dollars ($115 million x 10%). If 4% of the long-term capital gains could be deferred instead of the full 40%, the corresponding annual revenue decrease would have been $1.15 million ($11.5 million x 4% / 40%).

Long-Range Fiscal Implications

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Fiscal Estimate Worksheet - 2007 Session

Detailed Estimate of Annual Fiscal Effect

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I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):

II. Annualized Costs:	**Annualized Fiscal Impact on funds from:**	
	Increased Costs	Decreased Costs
A. State Costs by Category		
State Operations - Salaries and Fringes	$	$
(FTE Position Changes)		
State Operations - Other Costs		
Local Assistance		
Aids to Individuals or Organizations		
TOTAL State Costs by Category	**$**	**$**
B. State Costs by Source of Funds		
GPR		
FED		
PRO/PRS		
SEG/SEG-S		

III. State Revenues - Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, ets.)

	Increased Rev	Decreased Rev
GPR Taxes	$	$
GPR Earned		
FED		
PRO/PRS		
SEG/SEG-S		
TOTAL State Revenues	**$**	**$**

NET ANNUALIZED FISCAL IMPACT

	State	Local
NET CHANGE IN COSTS	$	$
NET CHANGE IN REVENUE	$SeeText	$

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