

STATE OF WISCONSIN

REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS

2019 ASSEMBLY BILL 56/SENATE BILL 59

[Introduced by the Joint Committee on Finance at the request of Governor Tony Evers.]

2019 Assembly Bill 56/Senate Bill 59 is the 2019-21 Executive Budget Bill prepared by the Governor and introduced by the Joint Committee on Finance at the request of the Governor. The bill contains a number of provisions that affect existing statutes or create new statutes relating to the exemption of property or persons from state or local taxes. This report addresses those provisions.

General Nature and Fiscal Effect of Tax Exemption Provision in

2019 Assembly Bill 56/Senate Bill 59

Exclusion for Nonfarm Capital Gains

The bill would limit the existing exclusion for nonfarm capital gains based on the taxpayer's federal gross income. Under current law, a taxpayer may exclude from income 30 percent of net long-term capital gains realized from the sale of assets held for more than one year and on assets acquired from a decedent. A taxpayer may also exclude from income 60 percent of long-term capital gains realized from the sale of farm assets held for more than one year or acquired from a decedent.

With one exception, under the bill, a taxpayer may not claim the nonfarm capital gains exclusion if the taxpayer's federal adjusted gross income (AGI) exceeds the following thresholds: (1) \$100,000 for an estate, a trust, a single individual, or an individual who files as a head of household; (2) \$150,000 for a married couple who files a joint return; and (3) \$75,000 for a married individual who files a separate return. However, a taxpayer whose AGI is below the specified threshold before 30 percent of eligible capital gains are added under federal law may claim the exclusion from state income tax, reduced by the amount of the taxpayer's AGI that exceeds the threshold.

The Legislative Fiscal Bureau (LFB) estimates that the fiscal effect of this provision would be to increase revenues \$285,100,000 in 2019-20 and \$220,000,000 in 2020-21.

Internal Revenue Code (IRC) Update

Under the bill, subject to certain exceptions, the state's income and franchise tax statutes would reference the IRC in effect on December 31, 2018, instead of December 31, 2017. In addition, the bill would adopt the following changes made to the IRC: loss limitation for taxpayers other than corporations; amortization of research and experimental expenditures; accounting rules for accrual method taxpayers; and limitation on the deductions for business interest, of Federal Deposit Insurance Corporation premiums, and for entertainment, amusement, and recreation expenses.

The LFB indicates that the administration estimates these provisions would increase revenues \$187,850,000 in 2019-20, \$174,450,000 in 2020-21, \$250,675,000 in 2021-22, and \$224,625,000 in 2022-23.

Private School Tuition Deduction

Under current law, a taxpayer who claims an elementary or secondary pupil as a dependent may deduct the tuition expense for the pupil's attendance in a private school, up to \$4,000 for each elementary pupil and up to \$10,000 for each secondary pupil. The bill sunsets this deduction, beginning with tax year 2019.

The LFB estimates that the fiscal effect of this provision would be to increase revenues \$12,100,000 in 2019-20 and \$12,200,000 in 2020-21.

Net Operating Loss Carrybacks

The bill repeals current law permitting a taxpayer to carryback net operating losses for two tax years in order to reduce the amount of income subject to individual income tax in those years. The bill leaves in place provisions that permit a taxpayer to carry forward net operating losses for up to 20 years. The repeal would first apply to tax year 2019.

The LFB indicates that the administration estimates the repeal of these provisions would increase revenues \$2,000,000 in 2019-20, \$4,100,000 in 2020-21, and \$2,000,000 in 2021-22 and 2022-23.

Deduction for Business Expenses for Moving Out-of-State

Beginning with tax year 2019, the bill prohibits individual income tax and corporate income and franchise tax deductions for moving expenses paid or incurred for moving a taxpayer's Wisconsin business operation, in whole or in part, to a location outside the state or to move the taxpayer's business operation outside the United States. The bill defines moving expenses to include: (a) vehicle rentals; (b) storage rentals; (c) moving company expenses for packing, unpacking, and transportation; (d) consulting fees and surveys; (e) brokerage commissions or fees; (f) architecture, design, and remodeling expenses; (g) expenses paid or incurred to sell property in Wisconsin; (h) loss on the sale of property in Wisconsin; (i) lease cancellation fees; (j) expenses paid or incurred for professional services, including legal services; (k) utility fees; (l) employee wages; (m) reimbursement of an employee's expenses; (n) the cost of meals, lodging, and fuel; and (o) mileage deductions for vehicle use. To the extent that a taxpayer deducted any such expenses for federal income tax purposes, the taxpayer would be required to add the amount back in to income for state tax purposes.

The LFB estimates that the fiscal effect of these provisions would be to increase revenues \$500,000 in both 2019-20 and 2020-21.

Sales Tax Exemption for Clay Pigeons and Game Birds

Under current law, clay pigeons and live game birds sold to licensed bird hunting preserves and clay pigeons sold to eligible shooting facilities are exempt from the state sales and use tax. The bill repeals this exemption beginning on the first day of the third month after publication of the bill.

The LFB estimates that the fiscal effect of this provision would be to increase revenues \$150,000 in 2019-20 and \$200,000 in 2020-21.

Sales Tax Exemption for Farm-Raised Deer

The bill repeals the sales and use tax exemption for farm-raised deer sold to a person operating a hunting preserve or game farm in Wisconsin. The repeal would first take effect on the first day of the third month after publication of the bill.

The LFB estimates that the fiscal effect of this provision would be to increase revenues \$90,800 in 2019-20 and \$121,000 in 2020-21.

Sales Tax on Medical Marijuana

The bill decriminalizes possession of 25 grams or less of marijuana and creates a regulatory framework for the licensing and registration of entities that sell medical marijuana and the registration of individuals suffering from certain conditions which may constitute a legal defense to the possession and use of medical marijuana. Under current law, the retail sale of prescription drugs is generally exempt from the sales and use tax. If the bill were enacted, medical marijuana could be a prescribed drug. However, the bill provides that, unlike other prescription drugs, the retail sale of medical marijuana by a licensed dispensary would be subject to the sales and use tax.

The LFB estimates that the fiscal effect of this provision would be to increase revenues \$252,100 in 2019-20 and \$504,200 in 2020-21.

Real Estate Transfer Fee Exemptions for Transfers Between Related Entities

When real estate is conveyed from one person to another, the person transferring the real estate must file a real estate transfer return with the Department of Revenue and must pay a real estate transfer fee unless an exemption applies. Current law provides that real estate transferred by a subsidiary corporation to its parent for no or nominal consideration is exempt from the real estate transfer fee. The bill clarifies that this exemption applies only if both the subsidiary and the parent are corporations.

Current law also provides that real estate transferred solely in order to provide or release security for a debt or obligation is exempt from the real estate transfer fee. Under the bill, this exemption does not apply if the debt or obligation was incurred as a result of a conveyance. The bill would first apply to conveyances made on the effective date of the bill.

The LFB estimates that the fiscal effect of these provisions would be to increase revenues \$538,500 in 2019-20 and \$718,000 in 2020-21.

Medical Care Insurance Deduction for Self-Employed Persons

Under current law, self-employed persons may deduct the amount paid for medical insurance up to a maximum of the person's aggregate net earnings from a trade or business that is subject to Wisconsin tax. A nonresident or part-time resident may also claim a deduction for medical insurance expenses, prorated based on the percentage of the person's net trade or business earnings that are subject

to Wisconsin tax relative to the person's total net trade or business earnings. The bill sunsets these provisions in tax year 2019, such that, beginning in tax year 2020, a self-employed resident's medical insurance expense deduction capped at the resident's aggregate wages, salary, tips, unearned income, and net earnings from a trade or business that is subject to Wisconsin tax. Likewise, a nonresident's or part-time resident's deduction will be prorated based on the percentage of the person's aggregate wages, salary, tips, unearned income, and net earnings from a trade or business that is subject to Wisconsin tax relative to the person's total income.

The LFB indicates that the administration estimates the provisions would reduce revenues by \$9,500,000 in 2020-21 and \$9,100,000 in 2021-22 and 2022-23.

First-Time Home Buyer Savings Accounts

The bill creates a tax-advantaged program under which an account holder may deduct the amounts deposited into a first-time home buyer savings account, up to \$5,000 per year for a single filer, or up to \$10,000 per year for a married joint filer. The bill limits the total amount that an account holder may deduct to \$50,000 per account for each beneficiary. Funds may be withdrawn from the account to pay for eligible costs, meaning a down payment and closing costs for the purchase of a single-family residence in Wisconsin. Any amount of funds withdrawn that are used for any other purpose must be added back into the account holder's income for state tax purposes. Likewise, any funds distributed following the dissolution of an account must be added back into the account holder's income for state tax purposes. The bill requires that an account be dissolved no later than 120 months (10 years) after its creation. The provisions would apply beginning in tax year 2020.

The LFB indicates that the administration estimates the provisions would reduce revenues by \$4,100,000 in 2020-21, \$6,200,000 in 2021-22, and \$7,500,000 in 2022-23.

Exclusion for Interest in Certain WHEFA Bonds and Notes

The bill creates an exemption from individual income tax and corporate income and franchise tax for interest earned on bonds or notes issued by the Wisconsin Health and Educational Facilities Authority (WHEFA), as long as the issued bonds or notes total \$35,000,000 or less and the interest income is not otherwise exempt. The exemption will first apply in tax year 2019, unless the bill takes effect after July 31, in which case the exemption will first apply in tax year 2020.

The LFB indicates that the administration estimates the provisions would reduce revenues by \$130,000 in 2020-21, \$260,000 in 2021-22, and \$390,000 in 2022-23.

Legality Involved

A provision of 2019 Assembly Bill 56/Senate Bill 59 raises a constitutional question based on the prohibition against a state discriminating against or unduly burdening interstate commerce. If enacted, this provision of the bill may be vulnerable to a challenge on these grounds.

Article I, Section 8 of the U.S. Constitution gives Congress the power "To regulate commerce...among the several states...." Well-established jurisprudence has interpreted the commerce clause as "contain[ing] an implicit prohibition (the "negative" or "dormant" commerce clause),

enforceable by the courts without congressional action, against a state's discriminating against or unduly burdening interstate commerce." [*W.C.M. Window Co. v. Bernardi*, 730 F.2d 486, 493 (7th Cir. 1984).] When evaluating a challenge under the commerce clause, courts first determine whether a law discriminates against interstate commerce. If the law discriminates, it will be upheld "only if it advances a legitimate local purpose that cannot be adequately served by reasonably nondiscriminatory alternatives." [*Department of Revenue v. Davis*, 553 U.S. 328, 338 (U.S. Supreme Court, 2008).]

A provision of 2019 Assembly Bill 56/Senate Bill 59 provides that a business may not deduct from its Wisconsin income or franchise tax liability expenses paid to move outside the state or outside the United States. This prohibition applies only to businesses that move outside the state or the United States, not to businesses that move within the state. This provision treats businesses differently based only on whether a business's move crosses state lines; it would appear to facially discriminate against interstate commerce. As noted above, if a law discriminates against interstate commerce, it will be upheld only if the state shows it advances a legitimate local purpose that cannot be adequately served by reasonably nondiscriminatory alternatives.

Public Policy Involved

The Joint Survey Committee on Tax Exemptions unanimously finds that the following tax exemption provisions of Assembly Bill 56/Senate Bill 59 are appropriate public policy:

- Deduction for business expenses for moving out-of-state.
- Real estate transfer fee exemptions for transfers between related entities.
- Medical care insurance deduction for self-employed persons.
- Exclusion for interest in certain WHEFA bonds and notes.

The Joint Survey Committee on Tax Exemptions finds that the remaining tax exemption provisions of Assembly Bill 56/Senate Bill 59 are appropriate public policy on a vote of Ayes, 5; Noes, 4.

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JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS