REPORT
STATE OF WISCONSIN
JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS
2023 ASSEMBLY BILL 406

[Introduced by Representative Katsma and cosponsored by Senator Marklein]

This report relates to 2023 Assembly Bill 406, relating to adopting changes to the federal Internal Revenue Code (IRC) for state tax purposes.

GENERAL NATURE OF PROPOSAL

2023 Assembly Bill 406 would adopt for state tax purposes Section 1202 of the IRC related to excluding the sale of qualified small business stock from taxable income, retroactive to tax year 2019, and including any future changes to that provision.

The bill updates state-law references to the IRC under the individual income and corporate income and franchise taxes to conform to most federal tax provisions enacted through federal legislation in 2021 and 2022.[1] These updates to state tax law would generally apply retroactively and for taxable years beginning after 2022.

The bill does not incorporate federal provisions under ARPA creating an income tax exclusion for certain forgiven student loans. Also, the bill does not include provisions in CAA22 and CAA23 authorizing a state income tax deduction for certain contributions to a health savings account for individuals covered by a high-deductible health plan.

Federal provisions adopted under the bill for state tax purposes include:

- **Earned income-tax credit (EITC).** Provisions under ARPA increasing the disqualified income limit for the EITC and authorizing married taxpayers filing separately to claim the EITC in certain cases.
- **Worldwide interest deduction.** A provision under ARPA permanently repealing an election for multinational taxpayers relating to allocation of interest expenses.
- **Multiple federally declared disasters.** A provision under the IIJA relating to tax deadlines in cases of federally declared disasters, including a significant fire.
- **Contributions to water and sewerage utilities.** Provisions under the IIJA allowing treatment of contributions to water and sewerage utilities as contributions to capital in certain cases.

[1] Federal enactments modifying the IRC during 2021 and 2022 included the American Rescue Plan Act of 2021 (ARPA), the Paycheck Protection Program Extension Act of 2021, the Surface Transportation Extension Act of 2021, the Further Surface Transportation Extension Act of 2021, the Infrastructure Investment and Jobs Act (IIJA), the Consolidated Appropriations Act of 2022 (CAA22), the Supreme Court Security Funding Act of 2022, the Inflation Reduction Act of 2022 (IRA), and the Consolidated Appropriations Act of 2023 (CAA23).

- **Carbon dioxide capture facilities and broadband projects**. A provision under the IIJA relating to a tax exemption for interest on qualified broadband projects and qualified carbon dioxide capture facilities.
- **College savings plan rollovers**. A provision in CAA23 that will enable 529 account beneficiaries to roll amounts remaining in a 529 account over to a Roth individual retirement account in certain cases.
- **Aviation fuel credit**. Provisions of the IRA modifying the definition of gross income for purposes of the federal sustainable aviation fuel credit.
- **Energy efficient commercial buildings**. Provisions of the IRA expanding the availability of deductions for energy-efficient commercial buildings.
- **Elective payment of applicable credits**. Provisions of the IRA allowing treatment of certain energy-related federal tax credits as payments of tax by qualifying entities.
- **Small employer pension plan startup costs**. Provisions in CAA23 relating to a tax credit for small business pension plan startup costs.
- **Sales to employee stock ownership plans (ESOPs)**. A provision under CAA23 modifying tax treatment of certain sales of stock to an ESOP, beginning in tax year 2028.
- **Achieving a better life experience (ABLE) age requirement**. A provision under CAA23 increasing the age limit for the initial occurrence of the blindness or disability of a qualified ABLE account beneficiary, beginning in tax year 2026.
- **Qualified conservation contributions**. Provisions under CAA23 relating to certain charitable donations of real property interests for conservation.

LEGALITY INVOLVED

The bill raises potential issues relating to the receipt of federal funds through the state fiscal recovery fund (SFRF) created under the ARPA. In total, Wisconsin received $2.53 billion in SFRF funds. ARPA prohibits states from using SFRF funds "to either directly or indirectly offset reduction in [their] net tax revenue" that results from a change in law that "reduces any tax." [42 U.S.C. s. 802 (c) (2) (A).] This is sometimes referred to as the "tax offset" provision under ARPA.

Treasury Determination

The question posed by the tax offset provision, in relation to Assembly Bill 406, is whether the U.S. Department of the Treasury (the Treasury) would determine there were insufficient funds from other sources to offset the reduction in revenue under the bill. The state Department of Administration (DOA) is responsible for reporting reductions in net revenue under ARPA. The department calculates that, as of August 28, 2023, the remaining margin for tax reductions before triggering potential recoupment is around $113 million for fiscal year 2023-24 and $319 million for fiscal year 2024-25. Meanwhile, the provisions in Assembly Bill 406 are estimated to cause the general fund balance to decrease by $10.2 million in 2023-24 and by $4.0 million in 2024-25, as described below. Therefore, it appears unlikely that the Treasury would determine there were insufficient funds from other sources to offset any reduction under the bill.

Federal Court Injunctions

In addition to the fact that an adverse determination from the Treasury appears unlikely, the outcomes in several recent court actions have cast doubt over the federal government's ability to enforce the tax offset provision under ARPA. Various states have filed lawsuits, individually or in combination with other states, against Treasury Secretary Janet Yellen and the Treasury, in relation to the enforcement of the provision.

Most significantly, the tax offset provision was held unenforceable by the U.S. Court of Appeals for the Eleventh Circuit, in *West Virginia v. U.S. Dep't of the Treasury*, 59 F.4th 1124 (11th Cir. 2023). The Eleventh Circuit upheld a lower court's order enjoining enforcement against 13 state plaintiffs. In its decision, the court affirmed that Congress is given spending authority in the Constitution and has the power to condition giving money to states on certain action, but that any conditions must be (among other factors) unambiguous. [*Id.* at 1140-41.] However, in this case, the court said the provision fails to provide a standard against which a state can assess whether it will reduce or has reduced net tax revenue, and it fails to define what a "direct or indirect offset" means. The court also said the novelty and scope of ARPA compounds those issues because the restriction is targeted at a state's entire budget. Ultimately, the Eleventh Circuit found in favor of the plaintiffs and upheld an injunction preventing the tax offset provision from being enforced against the 13 states. [*Id.* at 1144-47.]

Additionally, the U.S. Court of Appeals for the Sixth Circuit upheld an injunction blocking enforcement of the tax offset provision against Tennessee, one of the two state plaintiffs in *Kentucky v. Yellen*, 54 F.4th 325 (6th Cir. 2022). In its ruling on the merits, the Sixth Circuit found that the language of the offset provision was "impermissibly vague." [*Id.* at 330.] According to recent news reports, the Treasury has chosen not to appeal this decision.

Finally, in a lawsuit brought by Texas, Mississippi, and Louisiana, a federal district court in Texas upheld an injunction against enforcement of the tax offset provision against those states, in *Texas v. Yellen*, 597 F.Supp.3d 1005 (N.D. Tex. 2022). The court said it granted an injunction because the provision was coercive and commandeering. [*Id.* at 1012-15.] The U.S. Court of Appeals for the Fifth Circuit granted an appeal, and heard oral arguments on April 3, 2023, but the court has not yet released a decision.

In this case, if the Treasury sought recoupment of any SFRF funds expended by Wisconsin, as a result of the enactment of the bill, the state could contest the validity of the Treasury's action in court. This could include arguments against enforcement that have been successful in other jurisdictions.

FISCAL EFFECT

The provisions of Assembly Bill 406 relating to **worldwide interest deduction, multiple federally declared disasters, aviation fuel credit, energy efficient commercial buildings, elective payment of applicable credits, and small employer pension plan startup costs** are estimated to have a minimal effect on state tax revenues.

The fiscal impacts of the remaining provisions of Assembly Bill 406 are estimated as follows:

- **EITC** – the income-limit change is estimated to increase general purpose revenue (GPR) expenditures by $1.3 million in 2023-24 and $1.4 million in 2024-25, and the married-filing-separately change is estimated to increase GPR expenditures by $100,000 in 2023-24 and $200,000 in 2024-25.

- **Qualified small business stock** – the modified tax treatment of qualified small business stock is estimated to reduce state tax revenues by $14.7 million in 2023-24 and $5.5 million in 2024-25.
- **Contributions to water and sewerage utilities** – the exclusion of contributions from gross income is estimated to reduce state tax revenues by $1.2 million in 2023-24 and $1.0 million in 2024-25.
- **Carbon dioxide capture facilities and broadband projects** – the exemption on interest for qualifying projects is estimated to decrease state tax revenues by $0.3 million in 2023-24 and 2024-25 and by $0.4 million in 2025-26.
- **College savings plan rollovers** – the rollover provision is estimated to reduce state tax revenues by $0.8 million in 2023-24 and $2.0 million in 2024-25.
- **Sales to ESOPs** – the modified tax treatment of sales to ESOPs is not estimated to have a fiscal impact in the current fiscal biennium or the next. The change is estimated to reduce state tax revenues beginning in 2027-28 by $0.7 million (with continuing annual reductions growing to $5.1 million by 2031-32).
- **Achieving a better life experience (ABLE) age requirement** – the age requirement increase is not estimated to have a fiscal impact in the current fiscal biennium. The change is estimated to reduce state tax revenues by $0.3 million in 2026-27 (with continuing annual reductions growing to $2.5 million by 2031-32).
- **Qualified conservation contributions** – the modified tax treatment of qualifying charitable donations is estimated to increase state revenues by $8.2 million in 2023-24 and $6.4 million in 2024-25 (and declining to an increase of $3.3 million in 2027-28).

Taking into account all of the provisions described above, in the 2023-25 biennium, it is estimated that the bill would decrease the general fund balance by **$10.2 million in 2023-24** and by **$4.0 million in 2024-25**. Specifically, the EITC changes would increase state expenditures by $1.4 million general purpose revenue (GPR) in 2023-24 and $1.6 million GPR in 2024-25, and the bill would decrease state tax revenues by $8.8 million in 2023-24 and $2.4 million in 2024-25 (with continued annual reductions growing to $13.5 million by 2031-32).

The fiscal estimates used in this report were derived from materials originally prepared by the Legislative Fiscal Bureau based on publicly available information, including the language in each federal act and federal fiscal estimates prepared for the U.S. Congress, and consultations with and information provided by the state Department of Revenue.

PUBLIC POLICY INVOLVED

The Joint Survey Committee on Tax Exemptions finds that the tax exemptions created in the bill are good public policy on a vote of Ayes, 9; Noes, 0.

10/16/23 **JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**