REPORT
STATE OF WISCONSIN
JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS
2023 SENATE BILL 616

[Introduced by Senator Marklein and cosponsored by Representative Katsma]

This report relates to 2023 Senate Bill 616, relating to a sales tax exemption for road-building equipment; increasing the income tax withholding threshold for nonresidents; modifying the certification requirement for a qualified opportunity fund; prohibiting certain lottery games; and extending the capital gains exclusion to family members who inherit certain farms organized as a partnership or limited liability company.

GENERAL NATURE OF PROPOSAL

This bill makes various changes to current law provisions administered by the Department of Revenue (DOR).

Road Building Equipment

The bill creates an exemption from the sales and use tax for portable road-building equipment. This applies to the sale of portable machinery and equipment used primarily to crush, mill, produce, or pulverize asphalt, concrete, gravel, rock, or aggregate base for road or commercial surface lot construction or resurfacing.

Income Tax Withholding Thresholds

Under current law, a nonresident is not required to file a Wisconsin income tax return if their Wisconsin gross income is less than $2,000 in a year. However, an employer is not required to withhold taxes from wages paid to a nonresident if the total amount of the annual wages attributable to this state paid by the employer to that employee is less than $1,500. Also, a pass-through entity is not required to withhold amounts paid to a partner, member, shareholder, or beneficiary if the total annual wages paid to them, and attributable to this state, is less than $1,000. The bill increases these withholding thresholds for nonresident employees to $2,000.

Qualified Opportunity Funds

A Wisconsin qualified opportunity fund (WQOF) is a fund that holds at least 90 percent of its assets in qualified opportunity zone property in this state. Current law requires a WQOF to certify to its investors and DOR that it qualifies as a WQOF no later than January 31 following the close of its taxable year. The bill requires this certification to be made in the form and manner prescribed by DOR, no later than the due date, including extensions, of the corresponding income or franchise tax return.

Lottery Games

Current law requires the Lottery Division of DOR to post estimated prize payouts and the odds of a particular ticket winning for each game, as specified in the statute. The bill eliminates these requirements when the prize or odds are dependent on the number of participants. Also, under current law, a person who holds a winning lottery ticket or lottery share may claim a prize within

180 days after the prize is won, and a person who holds a winning ticket or share for an instant game or scratch-off game may claim a prize within 180 days after the game's end date. The bill authorizes the Administrator of DOR to determine a shorter period for which to claim a winning lottery ticket or lottery share in a multijurisdictional lottery secondary or subsequent chance drawing or game.

Farm Assets

Current law provides a capital gains income tax exclusion for "assets used in farming" that are held more than one year and sold or transferred to persons who are related to the seller. This includes shares in a farming corporation or trust engaged in farming, if it has no more than 15 shareholders or beneficiaries, and no more than two classes of shares, and if all its shareholders or beneficiaries are natural persons. Under the bill, "assets used in farming" also includes an ownership interest in a partnership or limited liability company, if the partnership or limited liability company has 15 or fewer partners or members and all are natural persons.

LEGALITY INVOLVED

The bill raises potential issues relating to the receipt of federal funds through the state fiscal recovery fund (SFRF) created under the American Rescue Plan Act (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 the bill, 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. It appears unlikely that the Treasury would make this determination in the current fiscal biennium, as explained below.

In its guidance, the Treasury has stated that a violation of the tax offset provision occurs when there is a reduction in net tax revenue caused by changes in the law and the state cannot identify sufficient funds from sources other than federal relief funds to offset the reduction in net tax revenue. [31 C.F.R. 35.8.] Statements issued by the Treasury in connection with its publication of the final rule refer to "three sources of funds that may offset a reduction in net revenue" without resulting in a violation, which are: "organic revenue growth, increases in revenue due to policy changes (e.g., an increase in tax rate), and certain cuts in spending." [See 31 C.F.R. Part 35, Final Rule, Supplementary Information, pg. 316.[1]]

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 was around $113 million for fiscal year 2023-24 and $319 million for fiscal year 2024-25. However, DOA assumes the general fund surplus cannot be included as available for covered tax reductions. This appears to contradict the Treasury's suggestion in the supplemental information accompanying the final rule, which is that organic revenue growth may offset revenue reduction, as described above.

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[1] Visit https://home.treasury.gov/system/files/136/SLFRF-Final-Rule.pdf to review the Treasury's supplemental information for 31 C.F.R. Part 35, Final Rule.

If the general fund surplus were taken into account, the remaining margin for tax reductions would be significantly greater. The opening balance of the general fund was estimated at $6.88 billion, as of July 1, 2023, according to the Legislative Fiscal Bureau (LFB). Because this was more than double the $2.53 billion SFRF monies received, it is reasonable to assume the state could identify funding from other sources to offset any revenue reduction under the bill for the current fiscal biennium. The state also maintains a budget stabilization fund, consisting primarily of excess state revenues over budgeted amounts, which had a cash balance of $1.79 billion, as of the end of May, 2023.

For these reasons, notwithstanding DOA's estimate, it appears unlikely that the Treasury would determine there were insufficient funds from other sources to offset the revenue reduction under the bill for the current fiscal biennium. With respect to future fiscal years, beyond the current fiscal biennium, it is unclear whether the tax offset provision under ARPA will continue to apply. The period covered by the tax offset provision ends on the last day of the fiscal year in which all SFRF funds have been expended by a state or returned to the Treasury. [31 C.F.R. 35.3.] If the tax offset provision under ARPA applies in future fiscal years, beyond the current fiscal biennium, the Treasury's likelihood of making an adverse determination may differ, depending on the amount and source of monies in the general fund at that time.

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. [Id. at 1144–47.]

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. As a result, the provision is not enforceable against Alabama, Arkansas, Alaska, Florida, Iowa, Kansas, Louisiana, Mississippi, Montana, New Hampshire, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, Utah, and West Virginia.

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.

Similarly to these states, 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

DOR estimates the following fiscal effects from the provisions in the bill described above:

- The exemption for **road building equipment** will decrease tax liability by approximately $5.5 million per year, but the actual decrease in sales tax collections is expected to be minimal given the level of compliance by affected parties under current law. As a result, DOR estimates that there is no effect on local sales tax revenues.
- The changes to **income tax withholding thresholds** is expected to result in minor revenue loss.
- The changes to **qualified opportunity fund** deadlines will not affect state revenue.
- The changes to **lottery games** would increase lottery sales by an indeterminate amount, which would result in an increase in the lottery and gaming credit (for 2023-24, the average lottery and gaming credit was $241).
- The changes to the capital gains exclusion for **farm assets** will reduce state revenue by approximately $260,000 annually.

Public Policy Involved

The Joint Survey Committee on Tax Exemptions finds that the tax exemption related provisions in the bill are good public policy on a vote of Ayes, 8; Noes, 0.

02/08/24 **JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS**