Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

November 30, 2005

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 297: Education Tax Credit

Assembly Bill 297, which would create an education tax credit, was introduced on April 5, 2005, and referred to the Assembly Committee on Colleges and Universities. AB 297 was recommended for passage by that committee by a vote of 6 to 3 and was referred to the Joint Committee on Finance on September 9, 2005.

CURRENT LAW

An employer may deduct educational expenses as business expenses if the education:

a. Maintains or improves skills required by the individual's employment, trade, or business; or

b. Meets the express requirements of the employer, or the requirements of applicable law or regulations imposed as a condition to the individual's retention of salary, status, or employment.

Educational expenses include amounts spent for tuition, books, laboratory fees, and similar items. Education includes tutorial instruction and formal training. The cost of a correspondence course may also be an educational expense.

Employer payments to a qualified educational assistance program are also deductible business expenses. An educational assistance program is a separate written plan that applies educational assistance only to employees. The program qualifies if all of the following tests are met:

a. The program benefits employees who qualify under rules established by the employer that do not favor highly-compensated employees.

b. The program does not provide more than 5% of its benefits during the year for shareholders or owners. A shareholder or owner is someone who owns more than 5% of the stock, capital, or profits interest in the business.

c. The program does not allow employees to choose to receive cash or other benefits that must be included in gross income instead of educational assistance.

d. The employer gives reasonable notice of the program to eligible employees.

For 2005, a highly-compensated employee is an employee who meets either of the following criteria: (a) the employee was a 5% owner at any time during the year or preceding year; or (b) the employee received more than $95,000 in pay for the preceding year.

An employer can exclude from wages up to $5,250 of educational assistance provided to an employee each year under an educational assistance plan.

SUMMARY OF BILL

Assembly Bill 297 would create a tax credit under the state individual and corporate income and franchise taxes (including the individual alternative minimum tax) equal to the following:

a. 50% of the tuition that the claimant paid or incurred during the tax year for an individual to participate in an education program of a qualified postsecondary institution, if the individual was enrolled in a degree-granting program; and

b. 75% of the tuition that the claimant paid or incurred during the tax year for an individual to participate in an education program of a qualified postsecondary institution, if the individual was enrolled in a degree-granting program, and if the individual's taxable income in the year prior to that in which the individual began participation in the degree-granting program was not more than 185% of the poverty line.

The tax credit would not be refundable, but unused credits could be carried forward up to fifteen years to offset future tax liabilities. Credits could not be claimed for any tuition amounts excluded from income for the Wisconsin tuition expense deduction or the federal employer educational assistance exclusion. Eligible claimants would include sole proprietors, partners, members of limited liability companies (LLCs), tax-option corporation (S corporation) shareholders, corporations, and insurance companies.

Corporations and insurance companies could claim the education tax credit to offset tax liabilities. Partnerships, tax-option corporations, and LLCs could not claim the tax credit, but eligibility for the credit and the amount of credit that could be claimed would be based on the tuition paid by the entity. A partnership, LLC, or tax-option corporation would be required to compute the amount of tax credit that each of its partners, members, or shareholders could claim and to provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations could claim the education tax credit in proportion to their ownership interest.

In order to claim an education tax credit, a taxpayer would be required to do the following:

a. Obtain written certification from a qualified postsecondary institution of the amount of tuition that the taxpayer paid or incurred during the tax year for an individual to participate in an education program of the institution, and include a copy of the certification with the taxpayer's return.

b. Where necessary, obtain written certification from a qualified postsecondary institution that the taxable income of the individual for whom the taxpayer has paid or incurred tuition for the individual to participate in an education program of the institution is not more than 185% of the poverty line for the tax year, and include a copy of the certification with the taxpayer's return. In cases where an individual for whom a taxpayer claims an education tax credit is claimed as a dependent on another person's tax return, the individual's income would be the taxable income of the person on whose return the individual was claimed as a dependent.

c. Certify to the Department of Revenue (DOR) that the taxpayer will not be reimbursed for any amount of tuition for which a tax credit is claimed.

A taxpayer could not claim an education tax credit for any tuition amounts that the claimant paid or incurred for the taxpayer's family member or a family member of a managing employee unless all of the following applied:

a. The family member was employed an average of at least 20 hours a week as an employee of the claimant, or the claimant's business, during the one-year period prior to commencing participation in the education program for which the taxpayer claims the credit.

b. The family member was enrolled in a degree-granting program that was substantially related to the taxpayer's business.

c. The family member was making satisfactory progress towards completing the degree-granting program.

"Degree-granting program" would be defined as an educational program for which an associate, a bachelor's, or a graduate degree is awarded upon successful completion. "Qualified postsecondary institution" would mean a University of Wisconsin System institution, a technical

college system institution, a regionally accredited four-year nonprofit college or university having its regional headquarters and principal place of business in Wisconsin, or a school approved by the veterans educational approval board, if that school has a physical presence and delivery of education occurs in Wisconsin. "Managing employee" would be an individual who wholly or partially exercises operational or managerial control over, or who directly or indirectly conducts, the operation of the claimant's business.

DOR would administer the education tax credit and current law provisions related to change of business or ownership and timely claims would apply to the credit. In addition, DOR would be required to biennially submit a report to the chief clerk of each house of the Legislature that would identify each qualified postsecondary institution for which it has received written certification of eligible education tax credit tuition having been paid, and that would specify the total amount of tuition for each such institution that was claimed as a credit in the previous biennium.

The education tax credit would first apply to tax years beginning on or after January 1, 2006.

FISCAL EFFECT

Assembly Bill 297 would create an education tax credit under the state individual and corporate income taxes equal to 50%, or 75% for low-income individuals, of the tuition paid for an individual enrolled in qualified post-secondary institution. The credit could be claimed for tax years beginning on or after January 1, 2006.

Based on information compiled by DOR from the University of Wisconsin System, the Wisconsin Technical College System, and the U. S. Office of Management and Budget, the tax credit would reduce income and franchise tax revenues by an estimated $9.3 million in 2005-06 and $20.6 million in 2006-07.

Prepared by: Ron Shanovich