



Legislative Fiscal Bureau

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

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Joint Committee on Finance

Paper #785

Convert Recycling Surcharge to Economic Development Surcharge (Wisconsin Economic Development Corporation and DNR)

[LFB 2011-13 Budget Summary: Page 326, #1 and Page 526, #1]

CURRENT LAW

For tax years beginning on or after January 1, 2000, the recycling surcharge is imposed on farm and nonfarm businesses that have more than \$4 million in "gross receipts from all activities." The recycling surcharge equals 3% of gross tax liability for corporations (including insurance companies and LLCs taxed as corporations), or 0.2% of net business income for sole proprietorships, partnerships, LLCs taxable as partnerships and tax-option (S) corporations. The minimum recycling surcharge is \$25 and the maximum is \$9,800. Sole proprietorships and partnerships engaged only in farming with more than \$4 million in gross receipts pay the \$25 minimum recycling surcharge. C corporations and S corporations solely engaged in farming determine surcharge liabilities in the same manner as other C and S corporations.

In general, "gross receipts from all activities" means gross receipts, gross sales, gross dividends, gross interest income, gross rents, gross royalties, the gross sales price from the disposition of capital assets and business assets, gross receipts passed through from other entities, and all other receipts that are included in gross income for Wisconsin income/franchise tax purposes.

Recycling surcharge payments, including interest and penalties, are deposited into the segregated recycling fund. Recycling fund revenues are primarily used to fund grants to county and municipal governments for implementing recycling programs, and for other state solid waste reduction programs.

The Department of Revenue is authorized to administer the recycling surcharge under provisions governing administration of the individual and corporate income and franchise taxes, including provisions relating to audits and assessments, claims for refund, statutes of limitations, IRS adjustments, confidentiality, appeals, collections, and set-offs for debts owed other state agencies.

Under Assembly Bill 40, the Department of Revenue is provided \$210,800 SEG

recycling fund revenues and 1.0 SEG position to collect, process, and enforce the recycling surcharge.

Total recycling surcharge collections were \$20.6 million in 2009-10.

GOVERNOR

Rename the segregated recycling and renewable energy fund (recycling fund) the "economic development fund." Rename the recycling surcharge the "economic development surcharge." Deposit the surcharge and \$4 per ton of the recycling tipping fee in the economic development fund. A new, segregated revenue, continuing appropriation funded with economic development fund revenues would be created under Wisconsin Economic Development Corporation (WEDC) to fund economic development programs administered by WEDC.

DISCUSSION POINTS

1. The disposition of the current \$7 per ton recycling tipping fee on most solid waste disposed in state landfills is addressed in a separate paper [LFB Paper #496]. The following table shows the condition of the Economic Development Fund under the bill.

TABLE 1

**Economic Development Fund
\$ in Millions**

	<u>FY12</u>	<u>FY13</u>
Opening Balance	\$0.00	\$4.74
Economic Development Surcharge	\$23.40	\$23.40
\$4 Tipping Fee	<u>20.40</u>	<u>20.80</u>
Annual Revenue	\$43.80	\$44.20
Revenue Available	\$43.80	\$48.94
WEDC Appropriation	\$38.85	\$39.85
DOR Surcharge Administration	<u>0.21</u>	<u>0.21</u>
Expenditures	\$39.06	\$40.06
Ending Balance	\$4.74	\$8.88

2. The recycling surcharge is imposed on individuals, estates and trusts, partnerships, tax-option (S) corporations, regular C corporations, including insurance companies, and the unrelated business income of tax exempt organizations that have \$4 million or more of gross receipts. The surcharge is 0.2% of net business income or 3% of gross tax liability, with a minimum surcharge of \$25 and a maximum of \$9,800, depending upon the type of business. Taxpayers who are subject to the recycling surcharge with net business incomes of \$12,500 or less, or gross tax liabilities of \$834 or less, pay the minimum surcharge of \$25, while taxpayers with net business incomes of \$4.9 million or more, or gross tax liability of \$326,700 or more pay the maximum

surcharge of \$9,800. The attachment illustrates the method of calculating the recycling surcharge for different types of taxpayers.

3. The current recycling surcharge evolved through a long and deliberative legislative process. The Legislative Council established the special Committee on Solid Waste Management in May 1988. The Subcommittee on Resource Recovery, was directed to study the adequacy and effectiveness of state and local solid waste management policies, including the use of recycling programs, landfills, or incinerators. Through a process of committee meetings and public hearings the Committee developed legislation that established a statewide recycling program for postconsumer waste, and was introduced by the Legislative Council as 1989 Senate Bill 300. The bill created a state segregated recycling fund as a source of revenues for state-supported recycling programs and a throwaway fee on single-use containers to fund appropriations from the segregated recycling fund. The fee would have been imposed on retailers, upon receipt of a single-use package, at a rate of 0.16 cents per package.

As SB 300 moved through the legislative process, the throwaway fee was eliminated and numerous alternative revenue sources were adopted by different standing committees and the Assembly and Senate. These funding sources included:

a. A sliding scale gross receipts fee on retailers, a sliding scale gross receipts fee on wholesalers, a net worth tax on corporations, and a disposable diaper fee adopted by the Senate Committee on Urban Affairs, Environmental Resources, Utilities, and Elections.

b. A sliding scale gross receipts fee applied to all corporations, including tax-option (S) corporations, sole proprietorships and partnerships adopted by the Joint Committee on Finance (JFC).

c. A modified sliding scale gross receipts fee imposed on sole proprietorships, partnerships, and corporations, including tax-option corporations, adopted by the Senate.

d. A sliding scale gross receipts fee imposed on every person required to hold a seller's permit for state sales tax purposes, a sliding scale gross receipts fee imposed on every corporation engaged in wholesale trade in Wisconsin, and a net worth tax imposed on manufacturers adopted by the Assembly Committee on Natural Resources.

e. Alternative sliding scale gross receipts fees imposed on nonfarm corporations, nonfarm partnerships, and individuals, estates and trusts required to file a federal return for profit and loss from a trade or business adopted by the Assembly. One gross receipts fee schedule was effective for tax years ending after April 1, 1991, and before April 1, 1993. A second schedule applied to tax years ending after April 1, 1993. The Senate concurred and Enrolled SB 300 was submitted to the Governor.

The recycling fee schedule included in enrolled SB 300 was substantially altered by the Governor's partial veto. As vetoed, the recycling fee increased from \$63 to a maximum of \$2,170 for firms with gross receipts of \$4,000,000 or more. Businesses with less than \$1,000,000 in gross receipts were exempt from the fee. In addition, the fee was imposed only for tax years ending after April 1, 1991 and before April 1, 1993. The bill was enacted as 1989 Wisconsin Act 335, and was projected to generate \$15.8 million annually. In his veto message for Act 335, the Governor indicated his intention to include an alternative funding mechanism for state-supported recycling

programs in the 1991-93 biennial budget.

As introduced by the Governor the 1991-93 biennial budget (1991 Assembly Bill 91) included proposed funding sources for the state recycling fund: (a) a flat fee imposed on all nonfarm businesses with gross receipts of \$4,000,000 or more; (b) an energy recycling fee imposed on the sale of electricity (0.08¢ per kilowatt hour) and natural gas (0.63¢ per therm) during the months of May through October; and (c) a used tire recycling fee of \$1.50 per tire assessed on the sale of all used vehicles.

In its actions on the budget, JFC deleted the gross receipts, residential energy, and used tire recycling fee provisions, and instead established a recycling surcharge based on the gross tax liability or net income of corporations and other businesses. All businesses were subject to the fee with a minimum payment of \$40 and a maximum payment of \$5,000. The surcharge was imposed on: (a) all corporations [including tax-option S and C corporations, and insurance companies] required to file state corporate income/franchise tax returns; (b) individuals, estates, and trusts required to file state individual income tax returns, and a federal schedule indicating a profit or loss from a trade or business; and (c) partnerships required to file a Wisconsin partnership return. For corporations the recycling fee was 3.9% of gross tax liability, For sole proprietorships, partnerships, and (S) tax-option corporations the recycling fee was 0.381% of net income. (This rate was equal to the basic corporate income/franchise tax rate of 7.9% times the surcharge rate of 3.9%, and had the effect of applying a surcharge to net income of all noncorporate businesses at essentially the same rate as that applied to corporations.) Noncorporate farms paid the minimum fee of \$40. All taxpayers were required to make estimated recycling fee payments by the unextended due date of their return. In addition, DOR was required, subject to approval by the Joint Committee on Finance, to annually estimate the amount of revenue to fund all appropriations from the recycling fund, and to establish the surcharge rate and minimum and maximum payments necessary to generate a sufficient level of revenue. The Legislature modified the surcharge provisions to: (a) increase the surcharge rate and maximum payment to 5.5% (or 0.4345% of net income) and \$9,800, respectively; (b) decrease the minimum payment to \$25; and (c) extend the period for which the surcharge was applied to tax years ending after April 1, 1992, and ending before April 1, 1999. The surcharge was named the "temporary recycling surcharge." because it was viewed as a source of funding for recycling programs only until markets for recycled products developed to provide municipalities with sufficient revenues from recycled waste items. The Governor vetoed a provision related to DOR determining the annual surcharge rate that made the recycling surcharge effective only for tax years ending between April 1, 1991, and before April 1, 1992. Subsequently, 1991 Wisconsin Act 60 was passed that included a provision that essentially restored the mechanism for determining the temporary surcharge rate for tax years ending after April 1, 1992 and before April 1, 1999.

Under 1993 Wisconsin Act 16 (the 1993-95 biennial budget act) the mechanism for determining the rate was changed, so that if Joint Finance changed the rate, it would apply to tax years beginning on or after the following January 1. In 1993, the Legislature increased the gross receipts exclusion for sole proprietorships and partnerships from \$1,000 to \$4,000. The 1995-97 biennial budget act (1995 Wisconsin Act 27) provided a \$4,000 exclusion for corporations.

The recycling fee of 5.5% of gross tax liability and 0.4345% of net business income remained in effect until tax year 1998. JFC changed the recycling surcharge for tax year 1998 to 2.75% of the gross tax liability of corporations and 0.2173% of the net business income of sole

proprietorships, partnerships, and tax-option corporations. Noncorporate farms paid the minimum fee of \$25. Sole proprietorships, partnerships, tax-option corporations, and corporations with less than \$4,000 in gross receipts were excluded from the recycling surcharge.

The recycling surcharge was eliminated for all businesses, beginning with tax years ending after April 1999. Consequently, taxpayers were generally not subject to the recycling surcharge for tax year 1999.

The recycling surcharge was re-imposed under provisions included in 1999 Wisconsin Act 9. The Conference Committee, and subsequently the Legislature, established a recycling surcharge for tax years beginning on or after January 1, 2000, with a tax rate of 3.3% of the gross tax liability of corporations and 0.2607% of the net business income of nonfarm sole proprietorships, partnerships, limited liability companies (LLCs) taxable as partnerships, and tax-option (S) corporations. Businesses (including farms) with \$1,000,000 or less in gross receipts would have been exempt from the surcharge. The maximum payment was established at \$20,000 and the minimum payment was \$25. The Governor item-vetoed these provisions to essentially create the current recycling surcharge. Specifically, the veto modified the surcharge to: (a) establish the surcharge rate at 3.0% of gross tax liability for corporations and 0.2% for sole proprietorships, partnerships, LLCs taxed as partnerships, and tax-option (S) corporations; (b) establish the maximum surcharge payment at \$9,800; and (c) exclude businesses with less than \$4,000,000 in gross receipts from the surcharge.

4. Table 2 shows total recycling surcharge collections from 1991-92 through 2009-10. Total collections during that time period were \$558 million.

TABLE 2
Recycling Surcharge Collections (\$ in Millions)

<u>Fiscal Year</u>	<u>Amount</u>
1991-92	\$32.1
1992-93	36.8
1993-94	47.7
1994-95	40.6
1995-96	41.6
1996-97	51.5
1997-98	53.6
1998-99	35.9
1999-00	9.6
2000-01	26.3
2001-02	12.5
2002-03	15.4
2003-04	25.5
2004-05	13.2
2005-06	19.5
2006-07	23.5
2007-08	25.1
2008-09	27.2
2009-10	<u>20.6</u>
Total	\$558.2

5. Table 3 shows recycling surcharge payments for fiscal year 2009-10 by type of taxpayer. Total payments shown for corporations includes both tax-option (S) and regular C corporations. Corporations, including tax-option (S) corporations, accounted for over three-fourths of total recycling surcharge payments, and have consistently accounted for this relative share of payments. In the table, adjustments include refunds, delinquent payments, and transfers to and from the general fund.

TABLE 3

Fiscal 2009-10 Recycling Surcharge Payments by Source

<u>Source</u>	<u>Amount</u>	<u>% of Total</u>
Corporations*	\$17,213,000	83.52%
Partnerships	5,769,500	27.99
Individuals	79,300	0.38
Adjustments	<u>-2,451,700</u>	<u>-11.90</u>
Total	\$20,610,100	100.00%

*Includes tax-option (S) corporations.

**Includes refunds, delinquent payments, and transfers.

6. Table 4 shows the distribution of recycling surcharge payments for tax year 2008, by adjusted gross income for individuals and by net business income for partnerships and corporations, including tax-option corporations. The table shows that 25,140 taxpayers paid the recycling surtax in tax year 2008. The average recycling surcharge paid was \$757. Partnerships (\$1,178) and tax-option corporations (\$895) exceeded the average for all taxpayers. Tax-option (S) corporations paid about 41% of total recycling surcharge payments; regular C corporations paid about 42% of total payments. Aggregate data also indicates that 1,254 partnerships, 3,211 tax-option (S) corporations, and 8,321 corporations paid the \$25 minimum recycling surcharge payment; while 134 partnerships, 172 tax-option (S) corporations, and 283 corporations paid the \$9,800 maximum payment. Total recycling surcharge collections for tax year 2008 will differ from total 2008-09 fiscal year collections, because fiscal year collections include estimated surcharge payments, final payments, transfers, and refunds from a number of different tax year returns, in addition to tax year 2008 returns. Also, amounts shown in the top income category for each type of taxpayer, such as \$1,000,000 to \$4,999,999, for individuals, may include amounts for taxpayers with incomes greater than the category limit. Those taxpayers' data have been included in a lower income category for confidentiality purposes.

TABLE 4**Recycling Surcharge by Type of Taxpayer**

	<u>Individuals</u>			<u>Partnerships</u>			<u>Tax Option (S) Corporations</u>			<u>Corporations</u>			<u>Total: All Taxpayers</u>		
	<u>Count</u>	<u>Amount</u>	<u>Average</u>	<u>Count</u>	<u>Amount</u>	<u>Average</u>	<u>Count</u>	<u>Amount</u>	<u>Average</u>	<u>Count</u>	<u>Amount</u>	<u>Average</u>	<u>Count</u>	<u>Amount</u>	<u>Average</u>
Less than \$0	25	\$2,497	100	941	\$23,525	25	1,895	\$47,375	25	6,765	\$169,125	25	9,626	\$242,522	25
\$0 to \$9,999	25	2,256	90	280	7,000	25	1,174	29,350	25	1,508	37,700	25	2,987	76,306	26
\$10,000 to \$24,999	21	1,236	59	157	5,261	34	547	18,762	34	671	26,585	40	1,396	51,844	37
\$25,000 to \$49,999	44	3,222	73	157	11,348	72	568	41,060	72	665	57,232	86	1,434	112,862	79
\$50,000 to \$99,999	63	3,678	58	153	22,677	148	668	97,016	145	760	130,411	172	1,644	253,782	154
\$100,000 to \$249,999	31	2,819	91	257	85,699	333	1,068	359,197	336	997	387,797	389	2,353	835,512	355
\$250,000 to \$499,999	27	9,248	343	200	142,808	714	848	609,679	719	672	566,628	843	1,747	1,328,363	760
\$500,000 to \$999,999	16	10,407	650	174	247,837	1,424	786	1,126,813	1,434	535	898,978	1,680	1,511	2,284,035	1,512
\$1,000,000 to \$4,999,999	10	24,484	2,448	323	1,446,176	4,477	920	3,748,820	4,075	648	3,331,122	5,141	1,901	8,550,602	4,498
\$5,000,000 to \$9,999,999				65	637,000	9,800	116	1,136,800	9,800	133	1,303,400	9,800	314	3,077,200	9,800
\$10,000,000 and above				<u>65</u>	<u>637,000</u>	<u>9,800</u>	<u>53</u>	<u>519,400</u>	<u>9,800</u>	<u>109</u>	<u>1,068,200</u>	<u>9,800</u>	<u>227</u>	<u>2,224,600</u>	<u>9,800</u>
Total	262	\$59,847	\$228	2,772	\$3,266,331	\$1,178	8,643	\$7,734,272	\$895	13,463	\$7,977,178	\$593	25,140	\$19,037,628	\$757

*The amounts shown in the top income category for each type of taxpayer (e.g. between \$1.0 and \$5.0 million for individuals) may include taxpayers with incomes greater than the category limit. Those taxpayers have been included in the lower income category for confidentiality purposes.

Source: Department of Revenue, 2008 corporate income/franchise and individual income tax aggregate statistics.

7. Department of Revenue (DOR) tax processing data for tax year 2009 indicate that through April, 2011, the Department had collected \$14,402,000 in recycling surcharge payments from 18,021 corporations, including tax-option (S) corporations. A total of 8,415 corporate returns included the minimum \$25 surcharge, while 221 corporate returns included the maximum \$9,800 payment. In addition, there were 193 returns where the surcharge was greater than the maximum, which would indicate combined returns where the surcharge was assessed on more than one combined group member. However, these would not be the only combined groups on which the surcharge was assessed. Processing information indicated that \$2,802,300 was collected from 2,478 partnership returns. A total of 1,155 paid the minimum surcharge, while 118 paid the maximum. DOR also collected \$85,600 from 298 individual income tax returns. A total of 3,100 paid the minimum recycling surcharge, and there was only one reported maximum payment. It should be noted that not all returns for tax year 2009 have been processed. DOR will receive tax year 2009 returns through October of 2011. However, tax year 2009 returns provide the only actual data for combined returns. DOR indicates that through April, of last year, approximately 89% of tax year 2008 returns were processed through the same date. Because combined reporting first applied to tax year 2009 the Department cannot determine if the same percentage of tax year 2009 returns have been processed.

8. Under Wisconsin combined reporting provisions, if at least one member of a combined group is conducting business in Wisconsin, all corporations in the group are considered to be doing business in Wisconsin. Each corporation in a combined group is considered a separate corporation for purposes of computing the recycling surcharge. Therefore, the \$4,000,000 gross receipts threshold, and the \$25 minimum and \$9,800 maximum payments, are determined separately for each entity in the combined group.

9. At the time the bill was introduced, annual recycling surcharge collections were estimated to be \$22.0 million annually in fiscal years 2010-11, 2011-12 and 2012-13. Based on year-to-date recycling surcharge collections and general fund tax collections forecast by this office, the recycling surcharge is reestimated to be \$23.4 million annually in 2010-11, 2011-12, and 2012-13. Through April, 2011, recycling surcharge collections totaled \$21.1 million, or \$500,000 higher than surcharge collections for all of fiscal year 2009-10. The economic forecast on which the office's general fund collection projections are based (HIS Global Insight, Inc. Baseline Forecast, January, 2011) projects a gradual increase in corporate profits from 2011 through 2013.

10. The state recycling program was established in response to concerns about municipal solid waste generation and disposal. Many landfills were closing and approaching capacity, and there were concerns about groundwater contamination from landfills, and of air pollutants produced from incineration. The economic policy rationale for recycling is that waste management is impeded by market failure because municipal solid waste collection and disposal services are incorrectly priced to reflect the full social costs of such activities. Municipal solid waste collection and disposal are typically funded by lump sum taxes or flat fees that provide no incentive to produce less waste, since the marginal cost of disposal is zero. Similarly, the cost of using recycled materials in production is overpriced from a social perspective, since procurement of recycled materials involves a number of costs including collection, separation, transportation, and reprocessing costs. This leads to too high of an aggregate level of municipal solid waste and too low of a level of recycling or source reduction measures. According to some analysts, (Menell, 1990) the result is product design, product choice, and disposal decisions that are overly resource intensive. Too much waste is produced and the product mix is not optimal. It will not reflect the

combination of products with the least-cost net environmental impact.

11. The recycling surcharge was enacted to fund state recycling programs designed to address these policy issues. Surcharge revenues fund state grants to municipalities and counties for local recycling programs. The recycling surcharge also provides a funding source for renewable energy grants and loans administered by the Department of Commerce. In past years, the recycling surcharge funded recycling market development programs to promote the development of markets for recovered materials and to maximize the marketability of these materials. The surcharge has also funded waste reduction and recycling grants to provide funding for projects to reduce the amount of waste generated or disposed of, and a recycling efficiency grant program to improve the operation of local recycling programs.

12. To an extent, the surcharge is also supported as a general means of imposing the costs associated with solid waste disposal on entities that generate solid waste. However, because the surcharge is based on the income of the business, the amount paid is not directly related to the amount of waste generated by the business. Further, since state recycling funds focus on municipal and residential recycling, the business tax is viewed by some as not sufficiently linked to waste generation.

13. Under the bill, the recycling surcharge would no longer be a source of funding for recycling programs. Instead, the surcharge would be renamed the economic development surcharge, and would be provided to the Wisconsin Economic Development Corporation (WEDC), in the corporation's segregated economic development fund revenues appropriation [s.20.192 (1) (r)] for funding economic development programs. DOR would continue to be provided \$210,800 SEG and 1.0 position annually to administer the economic development surcharge. In testimony before the Joint Committee on Finance, the Secretary of Commerce indicated that the funding level provided to WEDC would allow Wisconsin to narrow the gap compared to neighboring states in per capita investment in economic development. An organizational Competitive Assessment of Commerce (required by the 2009-11 biennial budget and conducted by AngelouEconomics), found that Wisconsin had both the lowest economic development operating budget and marketing budget per capita for 2009, compared to Iowa, Ohio, Michigan, Georgia, Louisiana, Illinois, Indiana, Minnesota, and Oklahoma. Wisconsin also had the fewest jobs per capita among these states. The economic development surcharge could provide WEDC with approximately \$23,150,000 SEG each year to fund economic development programs aimed at job creation and investment in Wisconsin (\$210,800 annually is provided to DOR to administer the surcharge).

14. Under the bill, the surcharge would no longer provide funding for programs intended to address the social costs related to municipal solid waste collection and disposal. From this view, the surcharge would essentially become an income or franchise surtax that would be imposed only on certain businesses. Moreover, surtax revenues potentially could be used by WEDC to fund relocation or expansion projects of competitor firms. State economic development incentives are supported because they create jobs and increase investments that benefit all state taxpayers and the state economy. This would argue for the use of general fund revenues to fund WEDC economic development programs. Consequently, the Committee may wish to eliminate the economic development surcharge, and instead provide WEDC with annual funding of \$23,400,000 GPR while deleting a corresponding amount of economic development fund SEG. The annual funding of \$210,800 SEG and 1.0 SEG position (and related appropriation [s. 20.566(1)(a)]) provided to DOR to administer the surcharge could be deleted [Alternative 2].

15. It should be noted that since the surcharge is based on net business income or gross tax liability, any change to state income and franchise tax provisions that would reduce or increase net income and/or tax liabilities would also affect surcharge payments. For example, reducing the state corporate income and franchise tax rate from 7.9% to 6.9%, would reduce annual surcharge payments by an estimated \$900,000.

ALTERNATIVES

1. Approve the Governor's recommendation to rename the recycling surcharge the "economic development surcharge" and deposit the surcharge in the economic development fund. Create a new, segregated revenue, continuing appropriation funded with economic development fund revenues [s. 20.192 (1) (r)] under the Wisconsin Economic Development Corporation (WEDC) to fund economic development programs administered by WEDC. Reestimate annual economic development surcharge revenues to be \$23,400,000 (rather than \$22 million under the bill).

ALT 1	WEDC Change to Bill Revenue
SEG	\$2,800,000

2. Delete the Governor's recommendation and repeal the surcharge. Delete funding of \$210,800 SEG and 1.0 SEG position annually and the related appropriation in the Department of Revenue to administer the surcharge. Instead, provide \$23,400,000 GPR annual funding to the Wisconsin Economic Development Corporation in its operations and programs appropriation and delete a corresponding amount of economic development fund SEG.

ALT 2	WEDC Revenue	WEDC Funding	DOR Funding	Positions	Net Change to Bill Funding	Positions
SEG	-\$44,000,000	-\$46,800,000	-\$421,600	- 1.00	-\$47,221,600	- 1.00
GPR		<u>46,800,000</u>	<u>0</u>		<u>46,800,000</u>	
Total	-\$44,000,000	\$0	-\$421,600	- 1.00	-\$421,600	- 1.00

3. Delete the Governor's recommendation. Reestimate annual recycling surcharge collections to be \$23,400,000.

ALT 3	WEDC Revenue	Change to Bill DNR Revenue	Net Revenue
SEG	-\$44,000,000	\$46,800,000	\$2,800,000

Prepared by: Ron Shanovich
Attachment

ATTACHMENT

Recycling Surcharge Computation

Individuals. The recycling surcharge applies to individuals, estates, and trusts that are required to file a Wisconsin income or fiduciary tax return having: (a) Wisconsin nonfarm trade or business activities; (b) income as a statutory employee in Wisconsin; or (c) farming activities in Wisconsin. A statutory employee is an individual who receives a wage statement, Form W-2, who has the "statutory employee" box checked. Statutory employees report their income on federal schedule for profit or loss from business, and net profit from business.

The recycling surcharge does not apply to: (a) individuals, estates, and trusts that are not required to file a Wisconsin income or fiduciary tax return or whose income from trade or business activities or farming is not subject to Wisconsin income taxation; (b) individuals estates and trusts that are not engaged in a trade or business, or in farming, and that do not have income as a statutory employee; (c) individuals, estates, and trusts that have less than \$4 million of gross receipts from a trade or business, farming activities, or services as a statutory employee for federal income tax purposes (d) individuals, estates, trusts, and statutory employees whose trade and business activities, farming activities, or services are entirely out-of-state; and (e) individuals, estates, and trusts whose income is passed through from a partnership, limited liability company (LLC) or tax-option (S) corporation. The recycling surcharge generally is imposed directly on the partnership, LLC or tax-option corporation.

"Gross receipts" for individuals, estates, trusts, and statutory employees means the total receipts from all trade or business activities and farming reportable by those entities for federal income tax purposes, before any deduction for returns and allowances. Gross receipts include: (a) gross receipts or sales reportable on federal Schedule C, profit or loss from business; (b) gross receipts reportable on federal Schedule C-EZ, net profit from business; (c) the gross sales price of assets includable in computation of ordinary income or loss on federal Form 497, sales of business property, and (d) gross receipts or sales reportable on federal Schedule F, profit or loss from farming.

"Net business income" is the net profit (all income less deductible expenses) from a trade or business, except farming, for federal income tax purposes. It includes net income received as a statutory employee and ordinary income or loss reported on the federal form for sales of business property. The net business income is reduced by the deduction for one-half of the federal self-employment tax paid on the nonfarm trade or businesses income on the federal individual income tax return, and the federal self-employed health insurance deduction.

A "trade or business" is an activity regularly carried on for a livelihood, or with the intention of making a profit. Trade or business income includes: (a) net profit from operating a nonfarm trade or business, or practicing a profession as a sole proprietorship, including amounts reportable as profit or loss from business, or net profit from business; (b) payments from a partnership to a partner not acting in the capacity of a partner and reported as profit or loss from business or net profit from business; and (c) other federal self-employment income.

"Farming" is the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity, including the raising, shearing, feeding, caring for, training, and management of animals. Trees, other than trees bearing fruit or nuts, are not treated as an agricultural or horticultural commodity. Raising or harvesting Christmas trees is not considered farming.

Example 1 illustrates the computation of the recycling surcharge:

Example 1: The taxpayer operates household appliance store in Wisconsin, with total gross receipts over \$4 million. The Wisconsin income tax return includes the following amounts from the federal income tax return.

Personal Interest Income	\$4,000*
Business Income	200,000
One-Half of Self-Employment Tax	-9,002
Self-Employed Health Insurance Deduction	<u>-4,800</u>
	\$186,198

*Not included in net business income.

The taxpayer is subject to a recycling surcharge of \$372 $([\$200,000 - \$9,002 - \$4,800] \times .002)$. Net business income does not include personal interest income from investments.

In general, net business income does not include capital gains income from the sale of capital assets, but does include ordinary gain from the sale of business assets. If a taxpayer operates more than one business, and one of the businesses has over \$4 million in gross receipts, the recycling surcharge is based on the total net business income of all of the businesses, even one or more of the businesses have less than \$4 million in gross receipts. In cases where there are multiple businesses net business losses from one business can offset net business income from another business. A husband and a wife that own separate businesses and who file joint federal and state returns compute the recycling surcharge separately from each other's business. Full-year Wisconsin residents that operate a business with establishments both in Wisconsin and out-of state, compute the surcharge based on all of the net income from the business, since the income of full-year residents is all taxable for Wisconsin income tax purposes.

Individuals engaged only in farming activities who have gross receipts of at least \$4 million, pay the minimum recycling surcharge of \$25. Net farm profit or loss is excluded from net business income in computing the recycling surcharge. The recycling surcharge for a taxpayer who is engaged in farming and another trade or business is the greater of \$25 or 0.2% of net business income (other than from farming), up to the maximum surcharge of \$9,800.

Partnerships (Including LLCs Treated as Partnerships). The recycling surcharge applies to every partnership, including an LLC that is treated like a partnership under the IRC, that must file a Wisconsin partnership return and, for federal income tax purposes, the partnership: (a) has at least \$4 million of gross receipts from trade or business activities; (b) is engaged solely in farming and has more than \$4 million of gross receipts from farming; or (c) is engaged in farming and other trade or business activities and has at least \$4 million of total gross receipts from all farm activities and nonfarm trade or business activities.

The recycling surcharge does not apply to: (a) partnerships that are not required to file a Wisconsin partnership return, including syndicates, pools, joint ventures or similar organizations that have elected not to be treated as partnerships under the federal internal revenue code (IRC); (b) partnerships that are not engaged in farming and have less than \$4 million of gross receipts from all trade or business activities for federal income tax purposes; (c) partnerships engaged solely in farming that have less than \$4 million of gross receipts from farming for federal income tax purposes and (d) partnerships engaged in both farming and other trade or business activities that have less than \$4 million of gross receipts from all farm activities and nonfarm trade or business activities for federal income tax purposes.

"Gross receipts" of partnerships are total receipts or sales from all trade or business activities and farming reportable by partnerships for federal income tax purposes, before any deduction for returns and allowances, or any other business expenses. Trade or business activities are determined at the partnership level, without regard to the passive activity limitations that may apply to a partner. Gross receipts include, but are not limited to, the sum of the following amounts reportable on the federal Return of Partnership Income, or accompanying schedules: (a) gross receipts or sales; (b) gross receipts passed through from other partnerships and fiduciaries; (c) the gross sales price from the sale or disposition of business assets; (d) gross receipts from the rental of real or tangible personal property; (e) gross receipts includable in computing other income or loss; and (f) gross receipts or sales from farming.

"Net business income" of partnerships is calculated by combing all items of income, loss, and deduction, including the following: (a) ordinary business income reported on the Wisconsin partnership and recycling surcharge return; (b) separately stated items of income, loss, and deduction reported on the Wisconsin form; (c) taxable state and municipal bond interest; and (d) appropriate transitional adjustments, depreciation differences, and basis differences. Partnerships that are engaged in both farming and nonfarming activities subtract net farm profit (or loss) when calculating net business income. "Farming" is the same definition that applies to individuals.

A trade or business is an activity regularly carried on by the partnership with the intention of making a profit.

Example 2. The partnership reports gross receipts of \$9.6 million, is doing business only in Wisconsin, and reports the following amounts on the Wisconsin partnership and recycling surcharge return.

Ordinary Business Income	\$200,000
Net Rental Real Estate Income (Loss)	-5,000
Guaranteed Payments	15,000
Interest Income	11,000*
Net Short-Term Capital Gain	3,000
Net Long-Term Capital Gain	2,000
Net Section 1231 Gain	1,000
Section 179 Deduction	-6,000
Contributions	-5,000
Investment Interest Expense	<u>-3,000</u>
	\$213,000

*Includes \$1,000 in state and municipal bond interest.

The partnership's net business income is \$213,000, which is the sum of its ordinary and separately state items of income and gain, minus its separately stated deductions, reported on the Wisconsin partnership form. Guaranteed payments made to partners who are acting in the capacity of partners are included in the partnership's net business income. The partnership is subject to a recycling surcharge of \$426 ($\$213,000 \times .002$).

Partnerships that report a net business loss must pay the minimum recycling surcharge of \$25. A partnership's net business income includes its distributive share of trade or business income from another partnership, even though that partnership is also subject to the recycling surcharge on the income. If a partnership is engaged in business both in Wisconsin and outside the state, the surcharge is based on the net business income that is allocated or apportioned to the state. Partnerships engaged solely in farming that have at \$4 million in gross receipts from farming for federal income tax purposes pay the minimum \$25 surcharge. As with individuals, the recycling surcharge for a partnership that is engaged in farming and another trade or business is the greater of \$25 or 0.2% net business income allocated or apportioned to Wisconsin, up to the maximum surcharge of \$9,800.

Tax-option (S) Corporations. The recycling surcharge applies to all corporations treated as S corporations under subchapter S of the IRC, that have at least \$4 million of gross receipts from all activities, that have not elected out of tax-option status for Wisconsin income tax purposes, and that are required to file a Wisconsin tax-option (S) corporation franchise or income tax return. The surcharge does not apply to: (a) tax-option corporations that are not required to file a Wisconsin income or franchise tax return; (b) tax-option corporations organized under Wisconsin law that have no business activities in Wisconsin; (c) tax-option corporations that have less than \$4 million in gross receipts from all activities; or (d) tax-option corporations not organized under Wisconsin law that do not have nexus (degree of business activities that establish jurisdiction to tax) with Wisconsin.

"Gross receipts" from all activities of a tax-option (S) corporation means the sum of the following items that are reportable on the federal S corporation return; (a) gross receipts or sales; (b) gross rents includable on the federal return in computing the income from real estate and other rental activities; (c) gross interest; (d) gross dividends; (e) gross royalties; (f) the gross sales price from the disposition of capital assets and business assets includable in computing gain or loss; and (f) gross receipts passed through from other entities, and all other receipts that are included in gross income for Wisconsin franchise or income tax purposes. The definition of gross receipts from all activities for tax-option (S) corporations does not have the same meaning as the definition of gross receipts for individuals, estates, trusts, and partnerships.

"Net business income" is the income/loss reconciliation of the aggregate amount of shareholders' pro rata share items. This is the total amount of all the shareholders' shares of the tax-option corporation's income, deductions, credits, and other items as computed under Wisconsin law.

Example 3. A tax-option corporation operating a business in Wisconsin reports \$4.2 million in gross receipts from all activities, and the following income, loss, and deduction items, as computed under Wisconsin law, on the Wisconsin tax-option (S) corporation return:

Ordinary Business Income	\$30,000
Other Net Rental Income	3,000
Interest Income	7,000
Net Long-Term Capital Loss	-5,000
Net Section 1231 gain	15,000
Section 179 Deduction	-10,000
Contributions	-4,000
Other Deductions	<u>-1,000</u>
	\$35,000

The tax-option corporation's recycling surcharge would be \$70 ($\$35,000 \times .002$).

Tax option corporations with negative or no income pay the minimum \$25 recycling surcharge. For tax-option corporations that do business in and outside of Wisconsin, the recycling surcharge is based on the net income apportioned to Wisconsin. The surcharge of multistate businesses operated by tax-option corporations is based on apportioned income, even in cases where all of the corporation's shareholders are residents of Wisconsin and report their pro rata shares of income or loss on their Wisconsin individual income tax returns. Tax-option corporations that operate a farm compute the surcharge based on the Wisconsin net income of the taxpayer.

Regular (C) Corporations (Including LLCs Taxed as Corporations). The recycling surcharge applies to all corporations that have at least \$4 million in gross receipts that must file a Wisconsin franchise or income tax return.

Corporations that are not subject to the recycling surcharge include: (a) corporations that are not required to file a Wisconsin franchise or income tax return; (b) corporations organized under Wisconsin law that have no business activities in Wisconsin; (c) corporations not organized under Wisconsin law that do not have the degree of activity for the state to establish jurisdiction to tax; (d) corporations that have less than \$4 million of gross receipts from all activities; and (e) nuclear decommissioning trust funds.

"Gross receipts from all activities means the sum of the following items reportable on the federal corporate income tax return: (a) gross receipts or sales; (b) gross dividends; (c) gross interest; (d) gross rents; (e) gross royalties; (f) the gross sales price from the disposition of capital assets and business assets includable in compute net gain or loss; and (g) gross receipts passed through from other entities, and all other receipts that are included in Wisconsin franchise or income tax purposes. The definition of gross receipts from all activities for corporations does not have the same meaning as the definition of gross receipts for individuals, estates, trusts, and partnerships

The recycling surcharge for regular C corporations is based on the corporation's gross tax liability computed for Wisconsin franchise or income tax purposes. LLCs taxed as corporations compute the surcharge tax same as C corporations.

Example 4. A corporation doing business in Wisconsin, reports gross receipts from all activities of \$4, 400,000 and gross tax liability of \$20,000.

The corporation is subject to a recycling surcharge of \$600 ($\$20,000 \times .03$).

Corporations that compute a gross tax liability of \$0 pay the minimum recycling surcharge of \$25. Since the computed gross tax liability is based on apportioned income, multistate

corporations compute the surcharge in the same manner as corporations that only do business in Wisconsin. Also, because the surcharge is based on gross tax liability, it is computed before any tax credits can be used.

Insurance Companies. Most insurance companies that conduct business in Wisconsin are subject to the state insurance premiums tax and not the corporate franchise or income tax. However, the state corporate franchise or income tax is imposed on most domestic nonlife insurance companies, and on the nonlife insurance business of domestic life insurance companies. The amount of tax that an insurance company pays under the state franchise or income tax cannot exceed 2% of gross Wisconsin insurance premiums.

The recycling surcharge applies to every insurance company that is required to file a Wisconsin franchise or income tax return, has business activity in Wisconsin, and has at least \$4 million of gross receipts from all activities. Companies that are not subject to the recycling surcharge include: (a) insurance companies that are not required to file a Wisconsin franchise or income tax return; (b) insurance companies that are not engaged in business in Wisconsin; and (c) insurance companies that have less than \$4 million in gross receipts.

"Gross receipts from all activities" of insurance companies means the sum of the following items that are reportable on the company's federal return: (a) gross premiums; (b) gross dividends; (c) gross interest income; (d) gross rents; (e) gross royalties; (f) the gross sales price from the disposition of capital assets and business assets includable in computing gain or loss; and (g) gross receipts passed through from other entities, and all other receipts that are included in the gross income for Wisconsin franchise and income tax purposes. The definition of gross receipts from all activities for insurance companies does not have the same meaning as the definition of gross receipts for individuals, estates, trusts and partnerships.

The recycling surcharge for insurance companies is based on the company's gross tax liability as computed for Wisconsin franchise or income tax purposes.

Example 5. An insurance company incorporated in Wisconsin and offering several types of insurance has Wisconsin net income from nonlife insurance activities of \$1.25 million, and gross premiums of \$4.9 million. Its gross tax is \$98,000 (the lesser of $\$1,250,000 \times 7.9\% = \$98,750$, or $\$4,900,000 \times 2\% = \$98,000$).

The insurance company's recycling surcharge would be \$2,940 ($\$98,000 \times .03$).

Tax-Exempt Organizations. Exempt organizations that generate unrelated business income are subject to the surcharge on their unrelated business income. Generally, exempt organizations that have, for federal income tax purposes, at least \$1,000 in gross income from a trade or business that is unrelated to the organization's exempt status, and from doing business in the state or from state sources, are subject to the Wisconsin franchise or income tax on that income. If these organizations have \$4 million or more in gross receipts from all activities they are also subject to the state recycling surcharge.

Taxpayers that are subject to the recycling surcharge may be required to make quarterly estimated surcharge payments. Individuals, estates, and trusts must make quarterly estimated payments if the sum of their Wisconsin net tax and the surcharge is \$200 or more. Partnerships must make quarterly payments if they owe at least \$200. Corporations must make quarterly estimated

recycling surcharge payments if the sum of their Wisconsin franchise or income tax due (minus tax credits) and surcharge is \$500 or more.

The Wisconsin recycling surcharge is generally deductible for federal income tax purposes, but not generally deductible for state franchise or income tax purposes. Administrative provisions that apply for Wisconsin franchise and income tax purposes, including those related to audits and assessments, claims for refund, statutes of limitations, IRS adjustments, confidentiality, appeals, collections and setoffs for debts owed other state agencies, also apply to the recycling surcharge.