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April 6, 2020

TO: Members
Wisconsin Legislature

FROM: Bob Lang, Director

SUBJECT: Federal Tax Law Changes Enacted in Response to the Coronavirus Outbreak

This memorandum provides information regarding certain federal tax law changes enacted in response to the coronavirus outbreak in 2020.

State individual income tax and corporate income/franchise tax provisions regarding the amount of income subject to taxation are generally referenced to definitions under federal law. With limited exceptions, changes to federal law take effect for state tax purposes only after action by the Legislature. The Legislature typically reviews the previous year's federal law changes each year to update state references to the federal Internal Revenue Code (IRC). Under current law, state tax references generally refer to the code in effect on December 31, 2017.

State references to federal law generally provide greater simplicity for taxpayers in preparing returns and reduce the administrative burden and cost for both taxpayers and the Department of Revenue (DOR) in assuring compliance with tax laws. The IRC references are used to determine which items of income are subject to taxation prior to specific state modifications. The state uses separate tax rates and brackets and separate provisions regarding standard deductions, personal exemptions, itemized deductions, net operating loss, and tax credits. Therefore, changes to these federal provisions typically have no effect for state tax purposes.

On March 18, 2020, the Families First Coronavirus Response Act (P.L. 116-127) was enacted by the federal government. In addition, on March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136) was enacted by the federal government. Both federal acts were in response to the coronavirus outbreak and make various changes to federal tax laws. Some of the more prominent tax changes in these federal acts will not affect Wisconsin income and franchise tax laws, such as refundable payroll tax credits for businesses that provide paid leave and the stimulus rebate for individuals available as an advance payment of a refundable income tax credit for tax year 2020. Several other provisions of the Coronavirus Aid, Relief, and Economic Security Act (referred to hereafter as "the Act") are relevant to Wisconsin's income and franchise tax laws.

A limited number of new provisions in the Act will automatically be adopted for state tax purposes, and were described in a memorandum distributed by this office to the Legislature on April 1, 2020. A description of these four provisions is also included in this memorandum. To adopt other relevant provisions of the Act, legislation to update references to the federal IRC is necessary.

The following sections provide a preliminary description of the federal tax provisions based on materials currently available for each of the relevant provisions in the Act, how they relate to Wisconsin tax law, and the estimated fiscal effect of adopting the provisions for state tax purposes for state fiscal years 2019-20 through 2022-23. This memorandum was prepared based on the language in the Act and on federal fiscal estimates published by the Joint Committee on Taxation, a nonpartisan committee of the U.S. Congress, on March 26, 2020. At present, guidance is not available from the Internal Revenue Service (IRS) regarding how these tax law changes will be administered. The fiscal estimates in this memorandum were prepared by the Department of Revenue (DOR), and the description for each provision was prepared in consultation with the Department.

As noted, this memorandum does not include a description of federal law changes in the Act for which Wisconsin has separate provisions, such as changes affecting federal credits or net operating loss. This memorandum also does not include a description of federal law changes affecting federal tax provisions that the Legislature previously chose not to adopt, such as modifications to the federal excess business loss deduction limitation for non-corporate filers and changes to the federal limit on the amount of interest expenses a business can deduct on their returns.

As noted above, the Legislature has adopted IRC provisions in effect as of December 31, 2017, although certain IRC provisions were excluded from the adoption. In addition to the two federal acts identified above, it should be noted that seven other federal acts have been adopted since the Legislature last modified state references to the IRC that are not described in this memorandum. These seven acts are included in 2019 Senate Bill 720 (SB 720), which has been messaged from the Assembly and is currently available for scheduling in the Senate. The proposed changes to IRC provisions in SB 720 are described in detail in the attached memorandum to Senator Marklein and Representative Wittke from this office, dated February 5, 2020. That memorandum was released by Senator Marklein and Representative Wittke at the executive session on SB 720 and Assembly Bill 754, held by the respective Senate and Assembly standing committees on February 6, 2020.

PROVISIONS AUTOMATICALLY ADOPTED

Required Minimum Retirement Distributions Waived

Under federal law, each employee's interest in a qualified retirement trust must generally begin to be distributed not later than the "required beginning date", which is generally defined as April 1 following the calendar year in which the employee reaches age 72 (70 and a half for individuals that reach the age of 70 and a half prior to January 1, 2020). After the first year, this required minimum distribution must be made by December 31 for each calendar year. The Act specifies that these required minimum distribution provisions do not apply for calendar year 2020 for certain defined contribution plans, or for an individual retirement plan, as established under federal law. It is estimated that this provision will reduce state individual income tax revenues by $34.0 million in 2019-20 and $41.0 million in 2020-21. However, it is estimated that income tax revenues will increase after 2020-21. A taxpayer's required minimum distribution is primarily based on the balance in their retirement account in the most recent calendar year. To the extent that waiving taxpayers' required minimum distributions in calendar year 2020 leads to higher aggregate account balances in succeeding years, the taxable distribution amounts in future years would be higher than under current law. The resulting estimated fiscal effect is an increase in individual income tax revenues of $6.0 million in 2021-22 and in 2022-23.

Certain Tax Filing Deadlines Extended

On March 13, 2020, President Trump declared a national emergency in response to the coronavirus outbreak. Following this declaration, the Treasury Department and Internal Revenue Service announced on March 21, 2020, that the deadline for filing federal income tax returns is extended from April 15, 2020, to July 15, 2020. Taxpayers who make estimated income tax payments that would otherwise be due on April 15 can make such payments by July 15 without incurring any interest or penalties, regardless of amounts owed by a taxpayer. A taxpayer need not file any additional forms in order to qualify for this extended due date.

Wisconsin law provides similar treatment such that state income and franchise taxpayers with tax filing due dates of April 15, 2020, will have until July 15, 2020, to file their state income or franchise tax returns for tax year 2019, or make their first tax year 2020 estimated payment, without interest, penalty, or underpayment interest applying until that date.

Under current law, individuals and corporations that make estimated tax payments during the tax year owe interest on any amount by which they underpaid their estimated payments for taxes owed when filing their tax return in the following year. This interest accrues at a rate of 12% per year for the period of the underpayment. However, underpayment interest does not apply under current law if the taxpayer qualifies for a federal extension of time to file their return due to a presidentially declared disaster. As a result of the federal actions described above, no underpayment interest will be owed on tax year 2019 estimated payments for taxpayers with a tax return due date of April 15, 2020 (now extended to July 15, 2020). It is estimated that the provisions described above will reduce state income and franchise tax collections by up to $28.0 million in 2019-20.

Single-Employer Pension Plan Deadline Extension

Federal law sets forth minimum required contribution rules for pension plans in order to meet plan funding targets. Under the Act, any minimum required contribution for single-employer pension plans which would otherwise be due in calendar year 2020 will be extended to January 1, 2021. The amount of each minimum required contribution will be increased by the interest which accrues during the period between the original due date and the date of payment of the contribution. This provision is expected to increase income and franchise tax revenues by $12.3 million in 2019-20, $14.2 million in 2020-21, and $1.6 million in 2021-22. However, the provision is expected to decrease income and franchise tax revenues by $2.5 million in 2022-23. By delaying their minimum required contributions in the short term, employers will forego the tax deduction they could otherwise claim for such payments. This will lead to a revenue increase in the short term, as highlighted above. The subsequent revenue decrease is expected to occur when employers resume such contributions (which will be larger due to the interest accrual described above), and claim the associated deductions on their income and franchise tax returns.

Certain Pension Plans Considered Defined Benefit Plans

Under federal law, a defined benefit plan provides a fixed, predetermined retirement benefit for employees. Generally, the employer makes contributions to such a plan (certain plans also allow or require employee contributions), and the employer can deduct such contributions from their income and franchise taxes. Under the Act, a cooperative and small employer charity pension plan is considered a defined benefit plan under federal law if, as of January 1, 2000, such plan was maintained by an employer that: (a) is a nonprofit under 501(c)(3), as defined under federal law; (b) has been in existence since at least 1938; (c) conducts medical research directly or indirectly through grant making; and (d) has the primary tax exempt purpose of providing services with respect to mothers and children. This treatment will apply to plan years beginning in tax year 2019. It is estimated that this provision will lead to a minimal reduction in state revenues.

PROVISIONS THAT WOULD REQUIRE LEGISLATIVE ACTION

Special Rules for Use of Retirement Funds

Treatment of Coronavirus-Related Distributions. In general, federal law imposes a 10% additional tax penalty on the amount of an early withdrawal (one made before the individual reaches a federally specified age) from certain qualified retirement accounts. State law provides that taxpayers taking early withdrawals must pay a state penalty of 33% of the amount of the federal penalty. The Act specifies that the federal tax penalty does not apply to any coronavirus-related distribution, which is defined as any distribution from an eligible retirement plan (as set forth under federal law) in calendar year 2020 to an individual: (a) who is diagnosed with SARS-CoV-2 or COVID-19; (b) whose spouse is diagnosed with either illness; or (c) who experiences certain adverse direct or indirect financial consequences as a result of either illness.

A coronavirus-related distribution cannot exceed $100,000 per individual in any taxable year, and can only be made in calendar year 2020. Any individual who receives a coronavirus-related distribution may, within three years of initial distribution, make contributions to an eligible retirement plan up to the amount initially distributed. Provided such repayments meet certain federal requirements, the amounts initially distributed would be excluded from gross income. When coronavirus-related distributions are not recontributed in this manner, the Act provides that the distribution be included in gross income over a three-year period.

Increase on Loan Limits from Qualified Employer Plans. Federal law treats loans from qualified employer retirement plans as distributions includible in gross income. However, up to $50,000 of such loans are not required to be treated as distributions. The Act increases this limitation to $100,000, and delays the due date for repayment of such loans by one year. This provision applies for loans made during the 180-day period beginning on the date of enactment of the Act.

State adoption of these provisions is estimated to increase individual income tax revenues by $0.4 million in 2019-20, and reduce such revenues by $12.1 million in 2020-21, $2.0 million in 2021-22, and $0.2 million in 2022-23.

Partial Above-the-Line Deduction for Charitable Contributions

The starting point for determining Wisconsin taxable income is federal adjusted gross income (federal AGI). To arrive at federal AGI, several additions and subtractions are made to an individual's gross income. The Act creates an additional subtraction by allowing up to $300 of qualified charitable contributions to be deducted from gross income in tax year 2020.

A qualified charitable contribution is one which is made in cash and meets certain other federal requirements. This deduction is available to taxpayers who claim the standard deduction (do not itemize their deductions). This provision applies only to tax year 2020. If adopted, it is estimated that the provision will reduce individual income tax revenues by $0.5 million in 2019-20 and $4.2 million in 2020-21. Because the provision is only in effect for tax year 2020, there is no estimated fiscal effect in subsequent fiscal years.

State law provides an itemized deduction credit equal to 5% of the amount by which certain federal itemized deductions (including the deduction for charitable contributions) exceed the state sliding scale standard deduction. It should be noted that if this provision is not adopted by Wisconsin, it is possible that itemized deduction credit claim amounts would increase, resulting in a reduction of state individual income tax revenues.

Suspension of Limitation on Certain Charitable Contributions

Federal law generally provides that an individual may deduct qualified charitable contributions equaling up to 50% of the taxpayer's federal AGI in that tax year (or 60% for cash contributions made between tax years 2018 to 2025). The Act permits qualified charitable contributions made in calendar year 2020 up to 100% of the taxpayer's federal AGI. Any amounts exceeding the taxpayer's federal AGI may be carried over to the next five taxable years.

For qualified contributions, the Act increases the limitation on the deduction for charitable contributions by corporate taxpayers from 10% of adjustable taxable income to 25%. Any amounts exceeding this limit may be carried over to the next five taxable years. Similar to current law, the current year contribution is deducted first with carryover contributions applied in chronological order.

"Qualified contribution" means any charitable contribution if paid in cash during calendar year 2020 and the taxpayer elects to treat the contribution as a qualified contribution, but does not include contributions to tax exempt organizations that are organized under section 509(a)(3) of the IRC to establish a new, or maintain a preexisting, donor advised fund. The provision is estimated to reduce state income and franchise tax revenues by $3.2 million in 2019-20 and $25.7 million in 2020-21. However, income and franchise tax revenues are expected to increase by $14.4 million in 2021-22 and by $4.4 million in 2022-23 because increasing the limitation on the deduction in 2020 will reduce the amount that would otherwise carry forward to be used over the next five years.

Telehealth Services for High Deductible Health Plans

Under federal law, contributions to a health savings account by an individual covered under a high deductible health plan are tax-deductible, subject to annual contribution limits. The Act specifies that a health plan shall not fail to be treated as a high deductible health plan by reason of failing to provide a deductible for telehealth and other remote care services. In the absence of this provision, an individual could not deduct contributions to a high deductible health plan that does not provide a deductible for telehealth and other remote care services for federal tax purposes. Such treatment applies to plan years beginning on or before December 31, 2021. It is estimated that state adoption of this provision will reduce individual income tax revenues by $0.4 million in 2020-21, $0.2 million in 2021-22, and by a minimal amount thereafter.

Additional Qualified Medical Expenses under Health Savings Accounts

Under federal law, a health savings account is established solely for the purpose of paying the qualified medical expenses of the account beneficiary. When a distribution is taken to pay for such expenses, the amounts are excluded from gross income.

Qualified medical expenses include any amounts paid by the beneficiary for medical care for themselves, their spouse, and their dependents, to the extent these amounts are not otherwise compensated for (such as through insurance). The Act stipulates that amounts paid for menstrual care products shall be treated as having been paid for medical care and thereby excluded from gross income. The Act defines menstrual care products to mean a tampon, pad, liner, cup, sponge, or similar product used by individuals with respect to menstruation or other genital-tract secretions.

The Act provides similar treatment for Archer medical savings accounts, health flexible spending arrangements, and health reimbursement arrangements, such that amounts paid for menstrual care products are treated as having been paid for medical care and excluded from gross income. This provision applies for distributions taken, and qualified medical expenses incurred, after December 31, 2019. State adoption of this provision is estimated to reduce individual income tax revenues by $0.2 million in 2019-20, $3.2 million in 2020-21, $4.2 million in 2021-22, and $4.5 million in 2022-23.

Paycheck Protection Loan Forgiveness

In order to assist businesses and their employees during the COVID-19 pandemic, the Act provides $349 billion for paycheck protection loans under the small business administration's (SBA) Section 7(a) loan guarantee program available for the period of time from February 15, 2020, through June 30, 2020 (the "covered period"). Paycheck protection loan funds may be used to cover: (a) payroll expenses; (b) costs related to group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (c) mortgage payments; (d) rent; (e) utility bills; and (e) other debt service obligations incurred before the covered period. Loans will be disbursed via the network of banks participating in the SBA's current Section 7(a) loan program, and, eventually, through other lenders determined by the SBA and the Secretary of the U.S. Treasury.

A portion of paycheck protection loans may be forgiven on a tax-free basis equal to the sum of payments for payroll expenses, mortgage payments, rent, and utility bills made during the eight-week period beginning on the date the loan was issued, not to exceed the principal amount of financing made available under the covered loan. The amount of loan forgiven may be reduced if the recipient does not maintain certain employment and wage thresholds specified in the Act. The amount of the loan forgiven is considered canceled debt income and excluded from federal gross income by the lender. The amount of loan forgiven that would otherwise be included in gross income of the eligible recipient is excluded from federal gross income under the Act.

Under state law, any canceled debt on a paycheck protection loan would be included into the borrower's Wisconsin income for purposes of the individual income tax and the corporate franchise/income tax. Because the paycheck protection loan program did not previously exist, such revenues are not part of prior estimates of general fund revenue. For that reason, it is estimated that conforming to federal law would not decrease state income and franchise tax collections compared to current estimates. On the other hand, if state law were not amended to conform to federal law, DOR estimates that state revenues would increase by $114.0 million in 2019-20, $102.0 million in 2020-21, $11.0 million in 2021-22, and a minimal amount thereafter due to increased collections from businesses receiving forgiveness on emergency loans under the payroll protection loan program including the forgiven amounts as taxable income in Wisconsin.

Exclusion for Certain Employer Payments of Student Loans

Under current law, payment of a debt paid on a taxpayer's behalf is generally considered income to that taxpayer. Certain exclusions from such income apply, such as up to $5,250 of qualified educational expenses paid by an employer on behalf of an employee. For payments made after the day of the Act's enactment and before January 1, 2021, the Act expands this exclusion to include payments of student loan principal and interest made by an employer on behalf of an employee. The limitation on the exclusion remains the same, such that the limitation of $5,250 applies to all combined payments of student loan debt and qualified educational expenses. An employee may not deduct loan interest for payments made by the employer. DOR estimates that conforming to federal law would decrease income and franchise tax collections by $0.6 million in 2019-20, by $2.1 million in 2020-21, and by a minimal amount thereafter.

Depreciation of Qualified Improvement Property

The Tax Cuts and Jobs Act of 2017 (TCJA) intended to provide a 15-year recovery period for qualified improvement property. However, due to a drafting error no such provision was included into the final language of the TCJA. Thus, in most cases qualified improvement property is treated as nonresidential real property having a 39-year recovery period (40 years under the alternative depreciation system). The Act corrects the drafting error to provide the intended 15-year recovery period retroactive to January 1, 2018. DOR estimates that conforming state law to this provision would decrease revenues by a minimal amount.

SUMMARY OF FISCAL EFFECTS

If the state were to adopt the aforementioned provisions, it is estimated that state income and franchise tax revenues would decrease by $4.5 million in 2019-20 ($54.2 million including automatically adopted provisions) and $47.5 million in 2020-21 ($74.3 million including automatically adopted provisions). If the Legislature did not adopt the exclusion from income for businesses that receive debt forgiveness through the paycheck protection loan program, estimated state tax revenues would be higher by $114.0 million in 2019-20 and $102.2 million in 2020-21. The following table shows the estimated state fiscal effect of adopting each provision described above.

Estimated State Fiscal Effects of Adopting Federal Tax Provisions in the Coronavirus Aid, Relief, and Economic Security Act
(In Millions)

	2019-20	2020-21	2021-22	2022-23
Provisions Automatically Adopted				
Required Minimum Distribution Waived	-$34.0	-$41.0	$6.0	$6.0
Certain Tax Filing Deadlines Extended	-28.0	0.0	0.0	0.0
Single-Employer Pension Plan Deadline Extension	12.3	14.2	1.6	-2.5
Certain Pension Plans Considered Defined Benefit Plans	Minimal	Minimal	Minimal	Minimal
SUBTOTAL	-$49.7	-$26.8	$7.6	$3.5
Provisions That Would Require Legislative Action				
Special Rules for Use of Retirement Funds	$0.4	-$12.1	-$2.0	-$0.2
Partial Deduction for Charitable Contributions	-0.5	-4.2	0.0	0.0
Suspension of Limitation on Certain Charitable Contributions	-3.2	-25.7	14.4	4.4
Telehealth Services for High Deductible Health Plans	-0.4	-0.2	Minimal	Minimal
Additional Qualified Expenses for Health Savings Accounts	-0.2	-3.2	-4.2	-4.5
Payroll Protection Loan Forgiveness	*	*	*	*
Exclusion for Certain Employer Payments of Student Loans	-0.6	-2.1	Minimal	Minimal
Depreciation of Qualified Improvement Property	Minimal	Minimal	Minimal	Minimal
SUBTOTAL	-$4.5	-$47.5	$8.2	-$0.3
TOTAL	-$54.2	-$74.3	$15.8	$3.2
TOTAL LESS AUTOMATICALLY ADOPTED	-4.5	-47.5	8.2	-0.3

*If state law were not amended to conform with the federal exclusion for cancellation of indebtedness under the new paycheck protection loan program created by the Act, state taxes on businesses receiving loan forgiveness would increase by $114.0 million in 2019-20, $102.0 million in 2020-21, $11.0 million in 2021-22, and a minimal amount thereafter.

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Attachment

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February 5, 2020

TO: Senator Howard Marklein
Representative Robert Wittke
State Capitol

FROM: Rick Olin, John Gentry, and Sean Moran

SUBJECT: Update Income and Franchise Tax References to the Internal Revenue Code

At your request, this memorandum provides a description of your proposal to update state tax references to the Internal Revenue Code (IRC). State individual income tax and corporate income/franchise tax provisions are generally referenced to definitions under federal law. With limited exceptions, changes to federal law take effect for state purposes only after action by the Legislature. Generally, the Legislature periodically reviews federal law changes to update state references to the IRC. Under current law, state tax references generally refer to IRC provisions enacted as of December 31, 2017.

State references to federal law generally provide greater simplicity for taxpayers in preparing returns and reduce the administrative burden and cost for both taxpayers and the Department of Revenue (DOR) in assuring compliance with tax laws. The IRC references are used to determine which items of income are subject to taxation prior to specific state modifications. The state uses separate tax rates and brackets and separate provisions regarding standard deductions, personal exemptions, itemized deductions, and tax credits. Therefore, federal changes to rates, brackets, deductions, and credits typically have no effect for state tax purposes.

During the last legislative session, the Legislature adopted IRC provisions in effect as of December 31, 2017, although certain IRC provisions were excluded from the adoption. Since then, seven federal laws have been enacted that affect the IRC. The seven acts are:

- the Bipartisan Budget Act of 2018 (P.L. 115-123);
- the Consolidated Appropriations Act of 2018 (P.L. 115-141);
- the Taxpayer First Act (P.L. 116-25);
- the Fostering Undergraduate Talent by Unlocking Resources for Education Act (P.L. 116-91);
- the National Defense Authorization Act for Fiscal Year 2020 (P.L. 116-92);
- the Further Consolidated Appropriations Act of 2020 (P.L. 116-94); and
- the Virginia Beach Strong Act (P.L. 116-98).

The proposal would amend the most recent definition of the IRC to apply only to tax years 2018 and 2019 and create a new definition of the IRC to include changes to the IRC adopted through December 31, 2019, effective for tax years 2020 and thereafter. The proposal would exclude certain items from the definition. These are items excluded under the current law definition, as well as certain provisions included in the Bipartisan Budget Act (BBA), the Consolidated Appropriations Act, and the Further Consolidated Appropriations Act. The excluded items were either enacted on a temporary basis, relate to provisions where Wisconsin has adopted a treatment different from the federal treatment (such as depreciation), or have a sizable fiscal effect. For example, the federal Tax Cuts and Jobs Act of 2017 (TCJA) included a number of provisions increasing business taxes that partially offset other tax reductions in the Act. Wisconsin did not previously adopt those provisions, and neither would this proposal adopt them. The federal provisions to be adopted would take effect at the same time for state purposes as for federal purposes, with limited exceptions.

Several of the seven enumerated acts are federal spending measures pertaining to federal fiscal years 2018 and 2020, but also include an assortment of federal tax provisions. Among the tax provisions in the Acts, not all of the tax law changes would have a state fiscal effect if adopted. The fiscal effects described below were provided by DOR. Depending on when the proposal would become law, some or all of the fiscal effects for 2019-20 may not be realized until 2020-21.

Bipartisan Budget Act. The BBA extended over 30 tax provisions that had been adopted on a temporary basis, but had expired at the end of 2016. These provisions were extended for one to four years, with the extension retroactive to tax year 2017. Many of the provisions relate to federal tax credits, which are not tied to state tax provisions. Other provisions in the federal act relate to tax relief for hurricane and California wildfire victims or to federal excise taxes. For these reasons, federalizing most of the permanent tax provisions in the BBA would not affect state tax collections. Nonetheless, several provisions would result in a state fiscal effect beginning in tax year 2020, if adopted by the state.

Qualified Opportunity Zones. Federal law allows states to designate certain low-income census tracts as qualified opportunity zones, and taxpayers may exclude certain capital gains from their taxable income if the gain is reinvested in a qualified opportunity zone within 180 days. The BBA designates each low-income census tract in Puerto Rico as a qualified opportunity zone. Because a limited number of Wisconsin taxpayers are likely to make a qualifying investment, a minimal effect on state revenues is estimated, reducing individual income tax collections by $300,000 in 2019-20 and $900,000 in 2020-21 and annually thereafter.

Contract Employees Serving in a Combat Zone. The BBA allows contractors or employees of contractors supporting the U.S. Armed Forces in designated combat zones to exclude their foreign earned income for tax purposes even if the individual has an abode in the United States. Adopting this provision would reduce individual income tax collections by an estimated $200,000 in 2019-20 and $600,000 in 2020-21 and annually thereafter.

Hardship Distributions from Retirement Plans. The BBA directs the Internal Revenue Service (IRS) to modify existing regulations related to hardship distributions from retirement plans by removing the six-month prohibition on making elective and employee contributions to a retirement plan after the receipt of a hardship distribution. Because contributions to retirement plans are generally made on a pre-tax basis, except for ROTHs, withdrawals are subject to tax. Under this provision, state tax revenues are estimated to increase by $600,000 in 2019-20 and annually thereafter.

Further Consolidated Appropriations Act. The Further Consolidated Appropriations Act of 2020 became law on December 20, 2019. It sets the overall spending limits for federal agencies and programs for the federal fiscal year ending September 30, 2020, and contains a number of retirement-related provisions that have been described as the most comprehensive retirement reform since the Pension Protection Act of 2006. In addition, the Act also contains a number of federal tax provisions, including the following provisions that would have a measurable effect on state tax revenues if adopted by the state.

<u>Disaster-Related Distributions from Retirement Plans</u>. The Act creates special disaster-related rules for uses of retirement funds in three areas related to federally declared disasters occurring between January 1, 2018, and 60 days after the Act's date of enactment. First, distributions from retirement plans, including Individual Retirement Accounts (IRAs), are not subject to the 10% additional tax on early withdrawals if the withdrawal is a qualified disaster distribution, does not exceed $100,000, and is repaid within three years. Distributions are included in the taxpayer's income for federal tax purposes, but may be allocated up to three years. Second, individuals who withdraw funds from a retirement plan for a first-time home purchase, but are unable to complete the purchase because of a disaster, may recontribute the funds to the plan without penalty, depending on the time of the withdrawal and the period of the disaster. Third, the Act increases the limit on funds that may be withdrawn from a qualified employer retirement plan as a loan, and not treated as a plan distribution, from $50,000 to $100,000, provided the loan is made within 180 days of the Act's date of enactment. Such loans are subject to repayment requirements, and the Act increases the five-year repayment period by one year for an individual whose residence is located in a qualified disaster area. Without adoption, Wisconsin taxpayers would be required to pay tax and a penalty on early retirement distributions. Adopting the provision would reduce state tax collections by an estimated $200,000 in 2019-20, $300,000 in 2020-21, and $100,000 in 2021-22 and 2022-23.

<u>Charitable Contributions for Relief Efforts in Qualified Disaster Areas</u>. The Act provides an increase in the limitation on charitable contributions allowed as deductions, provided the contribution is made for relief efforts in one or more qualified disaster areas and is made between January 1, 2018, and 60 days after enactment of the Act (December 20, 2019). For individuals, qualified disaster area contributions may not exceed the excess of the taxpayer's contribution base over the amount of all other contributions (not qualified disaster area contributions). For corporations, qualified disaster area contributions may not exceed the excess of the corporation's taxable income over the amount of all other (non-disaster) contributions. Adopting the provision would decrease state tax collections by an estimated $1,700,000 in 2019-20. No fiscal effect is estimated for 2020-21, and tax collection increases are estimated of $600,000 in 2021-22 and $300,000 in 2022-23. The increase would occur because the higher limitation would allow taxpayers to reduce their amount of carryover contributions deducted in subsequent years.

Casualty Losses in Qualified Disaster Areas. The Act increases the amount of casualty loss due to qualified disasters that may be claimed for federal tax purposes. The Act removes the requirement that the loss exceed 10% of federal adjusted gross income and allows the loss to be claimed either as an itemized deduction or as an increase in the standard deduction. Adopting the provision would reduce state tax collections by an estimated $2,000,000 in 2019-20, $2,300,000 in 2020-21, $1,100,000 in 2021-22, and $400,000 in 2022-23.

College Savings (529) Plans. The Act expands the definition of qualified education expense to allow 529 distributions to be used to pay for: (a) expenses associated with registered apprenticeship programs; and (b) principal or interest on qualified student loans of the account's beneficiary or a sibling of the beneficiary, limited to a lifetime maximum of $10,000. Regarding the latter provision, distributions used in this manner would not qualify for the student loan interest deduction that currently may be claimed as an adjustment to income for federal and state purposes. Adopting the provision would reduce state tax collections by an estimated $100,000 annually beginning in 2019-20.

Earned Income Tax Credit (EITC). The Act modifies the federal EITC and the refundable component of the child tax credit by allowing qualified individuals whose residence is in a disaster area to calculate their credit using their earned income from the prior year, instead of their earned income from the current year, provided their earned income from the prior year is higher. Typically, changes to the federal EITC are automatically adopted for purposes of the state EITC because the state credit is calculated as a percentage of the federal credit. However, this change is a non-IRC provision, so state adoption is not automatic. Because the state credit is refundable, the state budget system records the credit as a GPR expenditure. DOR reports that adopting this provision would increase GPR expenditures by an estimated $900,000 in 2019-20 and $700,000 in 2020-21. The provision would have no effect in 2021-22 and 2022-23.

Unrelated Business Income. Tax exempt organizations must pay tax on their unrelated business income, which is the income from a trade or business regularly carried on by the organization that is not substantially related to the organization's exercise or performance of its tax exempt functions or purpose. Effective for taxable years beginning after December 31, 2017, the TCJA required tax exempt organizations to add the cost of the following fringe benefits as unrelated business income for federal tax purposes: (a) qualified transportation fringe benefits (including qualified parking, transit passes, vanpool benefits, and qualified bicycle commuting reimbursements); (b) parking facilities in connection with qualified parking; and (c) on-premises athletic facilities. For example, the cost of employee parking provided by charities, churches, and other nonprofit entities is taxed as unrelated business income. Pursuant to 2017 Wisconsin Act 231, this treatment was adopted as part of state law. However, in December, 2019, the Further Consolidated Appropriations Act retroactively repealed this provision of the TCJA. The proposal would update state law to adopt the repeal prospectively, such that nonprofit organizations that pay certain fringe benefits relating to transportation, parking, and the use of athletic facilities would not be required to file a Wisconsin income tax return to pay taxes on such amounts for tax years beginning on and after January 1, 2020. Adopting the sunset of this provision would reduce revenues by $400,000 in 2019-20 and $900,000 annually thereafter beginning in 2020-21.

Summary of Tax Law Changes with a Fiscal Effect. The combined effect of the preceding nine provisions would be to: (a) reduce state tax collections (GPR-Tax) by an estimated $4,300,000 in 2019-20, $4,500,000 in 2020-21, $2,500,000 in 2021-22, and $2,100,000 in 2022-23; and (b) increase state GPR expenditures by $900,000 in 2019-20 and $700,000 in 2020-21. The net effect on the state's general fund is estimated at -$5,200,000 in 2019-20, -$5,200,000 in 2020-21, -$2,500,000 in 2021-22, and -$2,100,000 in 2022-23. These effects are limited to provisions in the Bipartisan Budget Act and the Further Consolidated Appropriations Act. The other federal acts containing IRC provisions are not expected to measurably affect state tax collections. A brief description of each act follows.

Consolidated Appropriations Act. The Consolidated Appropriations Act of 2018 became law on March 23, 2018. The Act made technical corrections to IRC provisions that had been enacted in 2015. Changes include correcting spelling and grammatical errors, as well as cross-references. Wisconsin had previously adopted the 2015 provisions, so the bill would adopt the technical corrections. In addition, the Act made technical corrections to the TCJA. Wisconsin adopted many of the TCJA changes in 2018 when it enacted Act 231, which also adopted some provisions from the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (P.L. 115-63). Therefore, adopting the Consolidated Appropriations Act clarifies that the provisions adopted in Act 231 will have the intended effects. Adopting these provisions is not expected to result in a state fiscal effect.

Taxpayer First Act. The Taxpayer First Act was signed into law on July 1, 2019. The Act revises provisions relating to the IRS, its customer service, enforcement procedures, cybersecurity and identity protection, management of information technology, and use of electronic systems. With one exception, adopting these provisions would not affect state tax collections. The Act's provision regarding equitable relief from joint liability could have a minimal state fiscal effect if adopted.

Fostering Undergraduate Talent by Unlocking Resources for Education (FUTURE) Act. The FUTURE Act became law on December 19, 2019, and "permanently authorizes funding for minority-serving institutions of higher education and increases the authorization of appropriations for Pell Grants." In addition, the Act authorizes the IRS, at the request of the Department of Education, to disclose tax return information to authorized persons related to student eligibility for several income-contingent or income-based determinations. DOR indicates that the tax-related provisions would have no tax effect on Wisconsin if adopted.

National Defense Authorization Act. The National Defense Authorization Act for Fiscal Year 2020 became law on December 20, 2019. The Act authorizes appropriations and sets forth policies for Department of Defense programs and activities, including military personnel strengths for the federal fiscal year ending on September 30, 2020. Also, the Act makes several changes to the IRC related to the definitions of qualified disaster, qualified disaster area, qualified disaster zone, and incident period, but these provisions would not have a fiscal effect on state tax collections if adopted, according to DOR.

Virginia Beach Strong Act. The Virginia Beach Strong Act became law on December 20, 2019, in response to the May 31, 2019, shootings in Virginia Beach, Virginia, which killed 12 people and wounded four others. The Act contains two tax provisions. One provision allows cash contributions for the relief of victims' families to be treated as charitable contributions. By adopting this provision, Wisconsin taxpayers could include such contributions in the calculation of the state itemized deduction tax credit. The second provision allows charitable organizations to make payments to the spouses or dependents of victims without violating the conditions of the organization's tax-exempt status. While no fiscal effect is estimated for these provisions, adopting the two provisions could reduce state tax collections by a minimal amount.

Other Proposed Changes. The proposal would also extend certain provisions in these acts to prior years, but those changes are not expected to have a fiscal effect. For example, a limited number of the technical corrections described under the Consolidated Appropriations Act would be extended to tax years 2014, 2015, and 2016. The retroactive provision also includes several pension and retirement related changes made by the Further Consolidated Appropriations Act.

The pension and retirement provisions in the Further Consolidated Appropriations Act would also be extended retroactively to tax year 2017, along with two provisions in the BBA. The two provisions, which had expired and been extended by the BBA through tax year 2017, pertain to the election to expense mine safety equipment and the deduction for energy efficient commercial buildings. These provisions are authorized under Section 179 of the IRC, and Wisconsin state statutes automatically adopted these federal changes.

For tax years 2018 and 2019, the proposal would extend provisions included in the BBA related to Section 179 expensing, the Taxpayer First Act related to equitable relief from joint liability, the Further Consolidated Appropriations Act related to retirement and pension plans, tax extenders, disaster relief, and unrelated business income, and the Virginia Beach Strong Act related to payments by charitable organizations to victims' families.

While the preceding provisions describe the IRC as it relates to the individual income tax, the proposal contains comparable provisions, where appropriate, to the definition of the IRC as it applies to the taxation of corporations, tax-option corporations, and insurance companies.

The proposal would also repeal obsolete references to the IRC for tax years 2005 through 2013. According to the Legislative Reference Bureau, repeal of these obsolete provisions would delete approximately 30 pages from the printed version of the statutes.

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