



Legislative Fiscal Bureau

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February 12, 2021

TO: Members
Wisconsin Legislature

FROM: Bob Lang, Director

SUBJECT: ASA 1 to AB 2: Modifications to the Department of Revenue and State Tax Laws

On Wednesday, February 10, the Joint Committee on Finance adopted ASA 1 to AB 2 and recommended the bill for passage, as amended.

This memorandum summarizes the provisions of ASA 1 to AB 2.

SUMMARY OF SUBSTITUTE AMENDMENT

The substitute amendment would adopt all of the provisions of AB 2, as described in a memorandum from this office to the Members of the Joint Committee on Finance dated February 10, 2021 (copy attached). Technical changes necessary to conform to the provisions of AB 2, including the technical changes included in Assembly Amendment 2 to AB 2, are also included in the substitute amendment. In addition, the substitute amendment would update statutory references to the Internal Revenue Code (IRC) under the state individual income and corporate income/franchise taxes to generally adopt IRC provisions in effect as of December 31, 2020 (rather than December 31, 2019, under AB 2) with exemptions.

The substitute amendment would amend the provision of AB 2 relating to the training requirements of a Board of Review of property tax assessments. The substitute amendment would require one member of the Board, rather than all members of the Board, to complete an annual training, and require that this training occur in person.

On January 22, 2021, this office provided a memorandum to the Wisconsin Legislature entitled "Federal Tax Law Changes in the Consolidated Appropriation Act of 2021 (CAA)," which identified five provisions of the CAA that were automatically adopted for state tax purposes and 15 provisions that Wisconsin could adopt for state tax purposes, but that would require legislative approval. Specifically, the 15 provisions of the CAA described in that memorandum that would require legislative approval are: (a) volunteer firefighters and emergency medical responders; (b)

exclusion for certain employer payments of student loans; (c) health care flexible spending arrangements (FSA); (d) production period for beer, wine, and distilled spirits for purposes of capitalizing interest; (e) minimum rate of interest for certain determinations related to life insurance contracts; (f) suspension of limitation on certain charitable contributions; (g) medical expense deduction floor; (h) casualty losses in qualified disaster areas; (i) qualified disaster relief contributions; (j) special rules for use of retirement funds; (k) emergency financial aid grants; (l) election to terminate transfer period for qualified transfers from pension plan for covering future retiree costs; (m) shortened alternative depreciation cost recovery period for residential rental property; (n) earned income tax credit (EITC); and (o) tax treatment of certain loan forgiveness and other business financial assistance, including the paycheck protection program (PPP), economic injury disaster loan (EIDL) program, payment assistance for certain loan payments, and grants to shuttered venue operators.

The substitute amendment would adopt all of the provisions of the CAA identified above. The CAA provisions would generally take effect for state tax purposes at the same time as for federal tax purposes.

FISCAL EFFECT

The substitute amendment is estimated to: (a) reduce general fund tax revenues by \$253,790,000 in 2020-21, \$215,175,000 in 2021-22, and \$71,275,000 in 2022-23; (b) increase GPR-Earned from the Department of Revenue by \$16,000 in 2021-22 and \$31,000 in 2022-23; and (c) increase estimated GPR expenditures for refundable tax credits by \$30,600,000 in 2020-21 and \$340,000 in 2021-22 and 2022-23. Depending on the timing of when the bill would be signed into law, a portion of the fiscal effect attributed to 2020-21 may occur in 2021-22. The table below provides detail regarding each of the proposed law changes that would have a fiscal effect on the general fund.

Under s. 16.518 (3) of the statutes, if actual tax collections exceed the amounts estimated in the state's biennial budget act, one-half of such excess is deposited into the budget stabilization fund. On January 26, 2021, this office prepared a memorandum projecting general fund tax revenues for the remainder of 2020-21 and the 2021-23 biennium, and estimated that the amount in the budget stabilization fund would total \$993.9 million at the end of 2020-21. The estimated effect of the substitute amendment would be a decrease in the estimated stabilization fund transfer of \$126.9 million in 2020-21.

Prepared by: Sean Moran
Attachment

**ASA 1 to AB 2: Net Fiscal Effect to General Fund
(Millions)**

	<u>2020-21</u>	<u>2021-22</u>	<u>2022-23</u>	<u>Total</u>	<u>Source</u>
IRC Provisions - CAA					
Volunteer Firefighter/EMT	-\$0.200	-\$0.400	-\$0.500	-\$1.100	GPR-Tax
Employer Paid Student Loans	-1.900	-3.500	-4.000	-9.400	GPR-Tax
Health and Dependent Care FSA	Minimal	0.200	0.100	0.300	GPR-Tax
Capitalizing Interest - Alcohol Production	-0.100	-0.100	-0.100	-0.300	GPR-Tax
Minimum Rate of Interest for Life Insurance	Minimal	-0.100	-0.400	-0.500	GPR-Tax
Increase Charitable Deduction Limit	-3.600	-13.500	3.800	-13.300	GPR-Tax
Medical Expense Deduction	Minimal	-5.100	-5.100	-10.200	GPR-Tax
Disaster - Casualty Losses	-0.400	-0.200	-0.100	-0.700	GPR-Tax
Disaster - Charitable Contributions	-0.700	Minimal	0.200	-0.500	GPR-Tax
Special Rules for Retirement Funds	-0.300	-0.200	Minimal	-0.500	GPR-Tax
Emergency Financial Aid Grants	-0.100	-0.100	Minimal	-0.200	GPR-Tax
Terminate Transfers from Pension Plan	0.300	0.300	0.200	0.800	GPR-Tax
Rental Property Depreciation	-6.000	-4.900	-1.900	-12.800	GPR-Tax
EITC for Tax Year 2020	30.600	Minimal	Minimal	30.600	GPR
PPP Loans and Other Business Assistance					
PPP Loan Forgiveness	-221.000	-152.000	-46.000	-419.000	GPR-Tax
EIDL Loan Program	-11.000	-12.000	-2.000	-25.000	GPR-Tax
Payment Assistance for Loans	-5.400	-8.300	-1.300	-15.000	GPR-Tax
Shuttered Venue Grant Program	-3.500	-3.900	-2.800	-10.200	GPR-Tax
Subtotal GPR-Tax	-\$253.900	-\$203.800	-\$59.900	-\$517.600	
Subtotal GPR	\$30.600	Minimal	Minimal	\$30.600	
IRC Provisions - Bipartisan Budget Act of 2018					
Qualified Opportunity Zones	\$0.000	-\$0.900	-\$0.900	-\$1.800	GPR-Tax
Contract Employees in Combat Zones	0.000	-0.600	-0.600	-1.200	GPR-Tax
Retirement Plan Hardship Distributions	<u>0.200</u>	<u>0.600</u>	<u>0.600</u>	<u>1.400</u>	GPR-Tax
Subtotal GPR-Tax	\$0.200	-\$0.900	-\$0.900	-\$1.600	
IRC Provisions - Further Consolidated Appropriations Act of 2020					
College Savings Plans	-\$0.100	-\$0.100	-\$0.100	-\$0.300	GPR-Tax
Unrelated Business Income	<u>Minimal</u>	<u>-0.900</u>	<u>-0.900</u>	<u>-1.800</u>	GPR-Tax
Subtotal GPR-Tax	-\$0.100	-\$1.000	-\$1.000	-\$2.100	
Other Tax Provisions					
Medical Care Insurance for Self-Employed	\$0.000	-\$9.500	-\$9.500	-\$19.000	GPR-Tax
Utility Tax Interest Rates	0.010	0.025	0.025	0.060	GPR-Tax
Objections to Manufacturing Assessments	0.000	0.016	0.031	0.047	GPR-Earned
Homestead, Defining Primary Income	0.000	0.140	0.140	0.280	GPR
Homestead, Retirement Interaction	<u>0.000</u>	<u>0.200</u>	<u>0.200</u>	<u>0.400</u>	GPR
Subtotal GPR-Tax	\$0.010	-\$9.475	-\$9.475	-\$18.940	
Subtotal GPR-Earned	\$0.000	\$0.016	\$0.031	\$0.047	
Subtotal GPR	\$0.000	\$0.340	\$0.340	\$0.680	
Totals					
GPR-Tax	-\$253.790	-\$215.175	-\$71.275	-\$540.240	
GPR-Transfer to Budget Stabilization Fund	-126.895	N/A	N/A	-126.895	
GPR-Earned	0.000	0.016	0.031	0.047	
GPR	<u>30.600</u>	<u>0.340</u>	<u>0.340</u>	<u>31.280</u>	
Net Effect on General Fund Balance	-\$157.495	-\$215.499	-\$71.584	-\$444.578	



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February 10, 2021

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 2: Modifications to the Department of Revenue and State Tax Laws

Assembly Bill 2 (AB 2) would make a number of changes to laws administered by the Department of Revenue (DOR).

AB 2 was introduced on January 15, 2021, and referred to the Assembly Committee on Ways and Means. That Committee held a public hearing on the bill on January 21, 2021. On January 21, 2021, that Committee adopted Assembly Amendment 2 (AA 2) to AB 2 by a vote of 12-0 and recommended AB 2, as amended by AA 2, for passage by a vote of 11-1. The bill was referred to the Joint Committee on Finance on February 8, 2021.

SUMMARY OF AB 2

Shared Revenue Program Payments. Clarify current law that any reductions in shared revenue payments required under current law could come from the county and municipal aid, utility aid, or expenditure restraint program payments that counties and municipalities receive on the fourth Monday in July and the third Monday in November. Amend various cross-references to reflect this modification. Specify that this modification first applies to distributions made in the year following publication. In addition, upon certification by DOR, permit the Department of Administration to distribute expenditure restraint program payments before the fourth Monday in July under certain circumstances. This provision first applies to the distributions made in the year following publication.

Payments from Counties to Towns. Delete the current law provision that prohibits county treasurers from making payments of money owed to town treasurers between the third Monday in March until 10 days after the annual town meeting.

Annual Inflation Adjustments. Modify the current law period used in determining the annual consumer price index (CPI) change for specific DOR-administered programs from the 12-

month period ending on September 30 to the 12-month period ending on August 31. Specify that this modification would apply to the allowable growth in joint fire service charges for the purpose of the annual municipal levy limit and for the allowable growth in municipal budgets under the expenditure restraint program. In addition, amend the date on which DOR must report the allowable change in the municipal budgets under the expenditure restraint program from November 1 to October 1 of each year.

Determination of Change in CPI. Modify current law that requires DOR to annually determine and certify to the State Superintendent of Public Instruction the change in the CPI between the prior March 31 and the second prior March 31, if not negative, to instead require DOR to only make such a determination and certification upon the request of the State Superintendent. The State Superintendent no longer uses CPI in the calculation of revenue limits for school districts.

Expanded Property Tax Exemption for Certain Religious Organizations. Delete the current law provision that requires the income from the lease of property owned by churches, religious organizations, and educational associations and institutions be used solely for maintenance or construction debt retirement, in order for the property to remain exempt from property taxation. Under the bill, leased property would remain tax-exempt, even if the leasehold income were to be used for purposes other than building maintenance or the retirement of construction debt. This provision would first apply to property tax assessments as of January 1, 2021.

Exempting taxable leased property owned by a church or religious organization would result in a tax shift among property taxpayers of local taxing jurisdictions. DOR's fiscal estimate indicates that the statewide effect of this provision is indeterminate as the Department does not have complete statewide parcel data on the affected properties. However, DOR estimates that for 2020(21) property taxes in the City of Milwaukee, the proposed exemption would result in a shift of \$185,600 in property taxes to other taxable properties and a minimal property tax increase on the City's remaining taxable properties.

Board of Review Training. Modify the training requirements for members of a local Board of Review of property tax assessments to require that all members complete annual training. Allow all but one of the members to complete this training online. Specify that this modification would take effect on the first January 1 after publication.

Administrative Fees Related to Local Property Assessments. Modify the current law fees relating to DOR's administrative role in local property tax assessments, effective the first January 1 after publication, as follows: (a) increase the fee for filing an appeal of a manufacturing property assessment to the state Board of Assessors from \$45 to \$200; and (b) delete the existing \$20 recertification fee for assessors and specify that if either DOR or a test service administers and grades an examination, the fee would equal the Department's best estimate of the actual costs to administer and grade the examination, but could not exceed \$75. It is estimated that the increase to the fee associated with manufacturing assessment appeals would increase GPR-Earned by \$31,000 annually. If passed into law in 2021, the fee increase would take effect on January 1, 2022, which would increase GPR-earned by \$16,000 in 2021-22 and \$31,000 in 2022-23.

Inclusion of Omitted Property Taxes on Tax Rolls. Modify the current law provision that property be placed on a taxation district's next tax roll if the total amount of omitted taxes exceeds \$5,000 to instead be included on that tax roll if the omitted taxes for any single description of property is \$250 or greater. Specify that any omitted taxes on a property in a tax incremental financing district may not be included on the omitted tax roll, unless the current value of the district is lower than the tax incremental base of that district in the assessment year for which the tax is collected. Require DOR to determine the amount of omitted taxes to be shared with each taxing jurisdiction for which the taxation district collected taxes and notify the taxation district. These provisions would first take effect on January 1 following publication.

Railroad Company Assessment Deadlines. Modify deadlines related to the taxation of railroad companies as follows: (a) the date for a railroad company to file their annual assessment report with DOR from April 15 to May 1; (b) the date for DOR to determine assessed values for railroad company property from August 1 to September 15; and (c) the date for DOR to determine the tax assessment for each company from August 10 to October 1. The new deadlines would be the same as those used for other public utility companies subject to the state ad valorem tax.

Interest on Amounts Owed to Public Utilities. Reduce the annual rate of interest paid by the state on amounts owed by DOR to public utilities from 9% to 3%, beginning on the effective date of the bill and applying to refunds associated with any previous tax year. State general fund tax revenues are estimated to increase \$10,000 in 2020-21 and \$25,000 in 2021-22 and annually thereafter. Refunds to airline and railroad taxpayers would affect the transportation fund, and refunds to other public utility taxpayers would affect the general fund. Due to the small amount of the estimated effect, the entire amount of the estimate would go to the general fund, which received 88% of public utility tax collections in 2019-20. A state tax in lieu of local property taxes is imposed on public utilities, including airlines, conservation and regulation companies, municipal electric associations, pipeline companies, railroads, and telephone companies subject to an ad valorem (property) tax and carline companies, electric cooperatives, and municipal and private light, heat, and power companies subject to a gross revenues tax. An identical reduction in the interest rate on refunds paid to other state taxpayers was enacted in 2013 Act 20.

Clarification of Subtraction for Disability Payments. Current law provides a subtraction from federal adjusted gross income (AGI) for disability payments, provided the individual receiving the payments meets certain criteria. The amount of the subtraction is based on calculation procedures and eligibility requirements that were referenced in an Internal Revenue Code (IRC) provision which was repealed in 1983. The bill would remove the IRC reference and replace it by specifying calculation procedures and eligibility requirements identical to those in the repealed IRC provision. This provision does not have a fiscal effect.

Homestead Credit Modifications. Under current law, for homestead credit claims filed for tax year 2017 and thereafter, claimants with no earned income are not eligible for the credit, unless the claimant, or the claimant's spouse, is at least 62 years of age or disabled in the year for which the claim is filed. However, earned income is not currently defined for purposes of the homestead credit. The bill would define earned income as wages, salaries, tips, and other employee compensation that are includible in federal AGI for the taxable year, plus the amount of the claimant's net earnings from self-employment for the taxable year. A claimant's earned income would be computed without regard to any marital property laws, and a claimant could elect to treat as earned income amounts

excluded from federal AGI as tax-exempt combat zone compensation. Earned income would not include: (a) any amount received as a pension or annuity; (b) certain other income received by a nonresident of the United States; (c) income received while a person is incarcerated; or (d) amounts received for service performed in work activities under the federal temporary assistance for needy families program, including work experience and community service programs, to the extent such amounts are subsidized under the program.

Current law requires the addition of certain disqualified losses to income for purposes of the homestead credit, unless the claimant is a farmer whose primary income is from farming and whose farming generates less than \$250,000 in gross receipts from the operation of farm premises for the year to which the credit claim relates. The bill would specify that a claimant's primary income is from farming if the claimant's gross income from farming for the year to which the claim relates is greater than 50% of the claimant's total gross income from all sources for the year to which the claim relates. "Gross income" would have the same definition as under the individual income tax.

These modifications would first apply to homestead credit claims filed for tax year 2021. This provision is estimated to increase program expenditures by \$140,000 GPR on an annual basis, beginning in 2021-22.

Medical Care Insurance Deduction for Self-Employed Individuals. A deduction is provided under current law for medical care insurance premiums paid by self-employed individuals. The deduction amount is limited to an individual's aggregate net earnings from a trade or business that are subject to Wisconsin tax. Nonresidents or part-year residents of Wisconsin are required to reduce the amount of the deduction according to the proportion of their total net earnings from a trade or business which are taxable in Wisconsin.

Beginning in tax year 2021, the bill would direct that the deduction amount be expanded to, instead, be limited to the individual's total wages, salary, tips, unearned income, and net trade or business earnings that are taxable in Wisconsin. The bill would similarly modify the proration calculation for nonresidents and part-year residents (described above) to provide that the deduction be reduced according to the percentage of the person's total wages, salary, tips, unearned income, and net trade or business earnings that are subject to Wisconsin tax. This provision would decrease individual income tax revenues by \$9,500,000 on an annual basis, beginning in 2021-22.

Repeal Obsolete Subtraction Statutes. The bill would repeal several individual income tax subtraction provisions that have been sunset and do not apply to current tax years. The provisions authorize reductions to federal AGI based on medical care insurance costs incurred between tax years 1993 and 2012.

Convert Retirement Income Exemption to a Subtraction. Current law provides an exemption from taxable income for up to \$5,000 annually of payments or distributions received from a qualified retirement plan under the IRC or an individual retirement account by an individual aged 65 or older. This treatment is limited to taxpayers with federal AGI below \$15,000 (\$30,000 if married). The bill would convert this exemption to a subtraction. According to DOR, eligible taxpayers must claim the exemption described above, whereas a taxpayer may choose whether to claim (or not claim) any of the subtractions provided under current law.

In certain instances, requiring a taxpayer to claim the retirement income exemption can lead to the taxpayer receiving a lesser homestead credit than if the exemption were optional. This is most likely to occur for individuals who would not owe state income tax regardless of whether they claim the exemption. As a result, their decision whether to claim the subtraction under the bill would not impact individual income tax revenues. However, homestead credit expenditures would increase under the bill, in cases where electing not to claim the subtraction would lead to receipt of a greater homestead credit. Because the homestead credit is refundable, the credit payments are GPR expenditures. It is estimated that the provision would increase GPR expenditures by \$200,000 on an annual basis. The provision would first apply in tax year 2021, and the fiscal effect would be realized beginning in 2021-22.

Internal Revenue Code Update. Beginning in tax year 2021, update statutory references to the IRC under the state individual income and corporate income/franchise taxes to adopt provisions in effect as of December 31, 2019, with exceptions. The provisions that would be adopted are described in detail in the attachment to this memorandum. The attachment reports that the fiscal effect of adopting the IRC provisions would increase state tax collections (GPR-Tax) by an estimated \$100,000 in 2020-21 and reduce state tax collections by \$1,900,000 in 2021-22 and annually thereafter. [A technical amendment to AA 2 would be needed to accomplish this intent.]

TABLE 1

Fiscal Effects of Adopting IRC Update

	<u>2020-21</u>	<u>2021-22</u>	<u>2022-23</u>	<u>Source</u>
Bipartisan Budget Act of 2018				
Qualified Opportunity Zones	\$0	-\$900,000	-\$900,000	GPR-Tax
Contract Employees in Combat Zones	0	-600,000	-600,000	GPR-Tax
Retirement Plan Hardship Distributions	200,000	600,000	600,000	GPR-Tax
Further Consolidated Appropriations Act of 2020				
College Savings Plans	-100,000	-100,000	-100,000	GPR-Tax
Unrelated Business Income	<u>Minimal</u>	<u>-900,000</u>	<u>-900,000</u>	GPR-Tax
Total Fiscal Effect				
GPR-Tax	\$100,000	-\$1,900,000	-\$1,900,000	

Supplement to the Federal Historic Rehabilitation Credit. Federal law provides a 20% tax credit for qualified rehabilitation expenditures (as defined under the IRC) for certified historic structures. A state credit of 20% is a supplement to the federal credit. Any person, including nonprofit entities, may sell or transfer the credit to any other Wisconsin taxpayer if the transferor notifies DOR in writing and submits a copy of the transferring documents.

The federal Tax Cuts and Jobs Act of 2017 provides that the federal tax credit must be claimed ratably over a five-year period (4% per year) for expenditures paid or incurred after December 31, 2017, instead of claiming the entire credit in the year the structure is placed in service. The state credit must be claimed at the same time that the federal credit is claimed, and thus must also be claimed ratably over a five-year period.

The bill would provide for technical changes to the procedure for transferring the credit to account for the federal law changes made to the timing for claiming the credit. Under the bill, at the time of the transfer request, the transferor of the credit would be able to claim the credit for more than one taxable year and would compute all years of the credit on a form prescribed by DOR. The bill would allow the transferee to claim, use, and carry forward the credit in the same manner allowed for the original claimant.

Partnership Adjustment. Under current law, Wisconsin taxpayers are required to amend their state tax returns any time the Internal Revenue Service (IRS) adjusts the taxpayer's federal income tax payable and the adjustment affects the state net tax payable. Pursuant to new partnership audit procedures provided under the federal Bipartisan Budget Act of 2015, the IRS may assess additional tax on a partnership's current year tax return at the entity level. As a result of the change in federal law, Wisconsin law does not clearly identify a filing requirement for a partner to file an amended Wisconsin tax return after an IRS partnership assessment is made at the partnership level because the federal partnership adjustment does not affect the individual partners' net tax payable. If partners do not notify DOR or amend their state tax returns, DOR may not know whether a taxpayer's state tax owed is affected until after receiving notice of the adjustment from the IRS. By that time, the statute of limitations may be closed or close to expiring for making an assessment or issuing refunds to the partners. The bill would require a partnership and its partners to report to DOR, within 180 days after the final determination, the IRS partnership adjustment and either concede the accuracy of the adjustment or state how the adjustment is erroneous. Further, the partnership and its partners must submit amended returns for the tax years to which the partnership adjustments relate.

Reporting of IRS Adjustments. Under current law, if the IRS changes or corrects the amount of federal net income tax payable, a credit claimed or carried forward, or a net operating loss or capital loss carried forward, the taxpayer must report such changes to DOR within 90 days of the IRS determination. Such changes need only be reported if they affect the corresponding amounts payable, claimed, or carried forward in Wisconsin. Similarly, a taxpayer filing an amended return with the IRS or with another state that affects any net tax, credit, or loss carry-forward amounts in Wisconsin must also file an amended return with DOR within 90 days of the filing date of the original amended return. Also under current law, DOR may make an assessment or refund if the Department provides notice to the taxpayer within 90 days of receipt of a required report or filing described above. The bill would extend these statutory deadlines to 180 days, rather than 90 days.

Examination of Sales Tax Returns and Related Reports. In general, current law prohibits DOR from allowing any person to examine the sales tax returns and associated documents submitted by any person, unless specifically authorized in statute. The bill would stipulate that the State Auditor and the employees of the Legislative Audit Bureau would be authorized to examine such documents to the extent necessary for the Bureau to carry out its duties set forth in statute.

Sales Tax Economic Nexus Threshold. Under current law, an out-of-state retailer (remote seller) is required to collect and remit sales tax if its annual gross sales or separate sales transactions in Wisconsin exceed \$100,000 or 200 transactions, respectively. The bill would remove the transactions portion from this economic nexus threshold, so that only a remote seller's annual gross sales would be considered in determining whether the seller must collect and remit sales tax. The bill would specify that a calendar year is the time period for determining annual gross sales. This provision would have a minimal fiscal effect.

Sales Tax Treatment of Certain Services. Under current law, a person who sells certain taxable services may purchase otherwise taxable goods without paying sales tax, only if those goods are physically transferred to the customer in conjunction with the taxable sale of the service. This treatment applies to taxable landscaping, printing, and photographic services, as well as taxable services to tangible personal property. The bill would specify that this treatment applies regardless of whether the sale is made to a customer who claims an exemption from the tax.

Under current law, a sales tax exemption is provided for containers, boxes, labels, and other packaging and shipping materials if used by the purchaser to transfer merchandise to customers. The bill would expand this exemption to also apply when such materials are physically transferred to the customer in conjunction with the provision of the types of services mentioned above, regardless of whether those services are subject to sales tax.

The bill would clarify that these provisions do not apply to services provided by veterinarians. These provisions are expected to reduce state tax revenues by a minimal amount.

Sales Tax Treatment of Nonprofit Entities. Under current law, otherwise taxable goods and services are exempt from sales tax when sold to nonprofit organizations that are operated exclusively for religious, charitable, scientific, or educational purposes, or for the prevention of cruelty to children or animals. The bill would modify this exemption to apply to an organization that is exempt from federal income tax under section 501(c)(3) of the IRC and has received a determination letter from the IRS certifying its tax-exempt status. The bill would specify that this exemption also applies to churches and religious organizations that meet the requirements under 501(c)(3), but are not required to apply for and obtain tax-exempt status from the IRS. DOR indicates that this provision would clarify its current treatment of such entities.

The intent of this provision is to simplify the process for obtaining a certificate of exempt status from DOR. The Department currently requires organizations to submit their IRS determination letter, their articles of incorporations or bylaws, and their statement of receipts and expenses for their last account period in order to obtain a certificate. However, under current law, an organization that does not have a determination letter may qualify for exempt status if it meets the requirements in the exemption. The bill is intended to eliminate the review by DOR and provide that only the IRS determination letter is necessary when applying for a certificate. Organizations that do not hold an IRS determination letter (except for religious organizations as described above), and organizations that have their determination revoked by the IRS, would not be eligible for exempt status from DOR. However, organizations eligible for exempt status under current law would continue to be eligible for exempt status under the bill if they have a determination letter from the IRS.

Sales Tax Exemption for UW Hospitals. Under current law, a sale of tangible personal property directly to the University of Wisconsin Hospitals and Clinics Authority is exempt from the sales and use tax; however, purchases of tangible personal property by contractors on behalf of the Authority are not. Current law also provides a sales tax exemption for the sale of tangible personal property to construction contractors, if that property is transferred to the following entities as part of constructing a Wisconsin facility owned by that entity: (a) local units of government; (b) technical college districts; and (c) institutions and campuses of the University of Wisconsin System. The bill would expand this list to provide a sales tax exemption for construction contractors to purchase property or items in fulfillment of a real property construction activity for the University of

Wisconsin Hospitals and Clinics Authority if the property or items become a component of a facility in Wisconsin that is owned by the Authority. Specify that this provision would first apply to contracts entered into on the effective date of the bill. This provision is estimated to have a minimal effect on state revenues.

SUMMARY OF AA 2 TO AB 2

AA 2 is a technical amendment necessary to conform to the provisions of AB 2, as described above.

FISCAL EFFECT

AB 2, as amended by AA 2, is estimated to: (a) increase general fund tax revenues by \$110,000 in 2020-21 and reduce general fund tax revenues by \$11,375,000, in 2021-22 and 2022-23; (b) increase GPR-Earned from DOR by \$16,000 in 2021-22 and \$25,000 in 2022-23; and (c) increase estimated GPR expenditures for refundable tax credits by \$340,000 in 2021-22 and 2022-23. Table 2 provides detail regarding each of the proposed law changes that would have a fiscal effect on the general fund.

TABLE 2

AB 2 as Amended by AA 2: Net Fiscal Effect to General Fund (Millions)

	<u>2020-21</u>	<u>2021-22</u>	<u>2022-23</u>	<u>Total</u>	<u>Source</u>
Provisions of AB 2					
IRC Update	\$0.100	-\$1.900	-\$1.900	-\$3.700	GPR-Tax
Medical Care Insurance for Self-Employed	0.000	-9.500	-9.500	-19.000	GPR-Tax
Utility Tax Interest Rates	0.010	0.025	0.025	0.060	GPR-Tax
Objections to Manufacturing Assessments	0.000	0.016	0.031	0.047	GPR-Earned
Homestead, Defining Primary Income	0.000	0.140	0.140	0.280	GPR
Homestead, Retirement Interaction	0.000	0.200	0.200	0.400	GPR
Totals					
GPR-Tax	\$0.110	-\$11.375	-\$11.375	-\$22.640	
GPR-Transfer to Budget Stabilization Fund	0.055	N/A	N/A	0.055	
GPR-Earned	0.000	0.016	0.031	0.047	
GPR	<u>0.000</u>	<u>0.340</u>	<u>0.340</u>	<u>0.680</u>	
Net Effect on General Fund Balance	\$0.055	-\$11.699	-\$11.684	-\$23.218	

Under s. 16.518(3) of the statutes, if actual tax collections exceed the amounts estimated in the state's biennial budget act, one-half of such excess is deposited into the budget stabilization fund. On January 26, 2021, this office prepared a memorandum projecting general fund tax revenues for the remainder of 2020-21 and the 2021-23 biennium, and estimated that \$231.8 million would transfer into the budget stabilization fund in 2020-21, which would increase the total fund balance to \$993.9 million. Thus, the estimated effect of the bill on the budget stabilization fund would be a decrease in the estimated stabilization fund transfer of \$55,000 in 2020-21.

Under s. 16.47 (2), no bill containing an appropriation or increasing or decreasing state revenues in an annual amount exceeding \$10,000 can be passed by the Senate or the Assembly unless an emergency statement is attached to the bill. AB 2, as amended by AA 2, would: (a) reduce state revenues by more than \$10,000; and (b) require an emergency statement prior to being passed in either House of the Legislature.

Prepared by: Sean Moran and Al Runde
Attachment

ATTACHMENT

Assembly Bill 2 as Amended by Assembly Amendment 2: Income and Franchise Tax Provisions Modifying References to the 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 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.

The Legislature previously adopted IRC provisions in effect as of December 31, 2017, although certain IRC provisions were excluded from the adoption. Since then, 10 federal laws have been enacted that affect the IRC. The 10 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);
- the Virginia Beach Strong Act (P.L. 116-98);
- the Families First Coronavirus Response Act (P.L. 116-127);
- the Coronavirus Aid, Relief, and Economic Security (CARES) Act (P.L. 116-136); and
- the Consolidated Appropriations Act of 2021 (P.L. 116-260)

The bill would amend the most recent definition of the IRC to apply only to tax years 2018, 2019, and 2020. It would create a new definition of the IRC to include changes to the IRC adopted through December 31, 2019, effective for tax years 2021 and thereafter. The bill 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 of 2018, and the Further Consolidated Appropriations Act of 2020. The bill would not include any provisions of the Consolidated Appropriations Act of 2021.

In general, the excluded items were either enacted on a temporary basis, related 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 the bill would not 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 10 enumerated acts are federal spending measures pertaining to federal fiscal years 2018, 2020, and 2021, 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 bill would become law, some or all of the fiscal effects for 2020-21 may not be realized until 2021-22.

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 under the bill would result in a state fiscal effect beginning in tax year 2021.

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 small effect on state revenues is estimated, reducing individual income tax collections by \$900,000 on an annual basis beginning in 2021-22.

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 \$600,000 on an annual basis beginning in 2021-22.

Hardship Distributions from Retirement Plans. The BBA directs the Internal Revenue Service (IRS) to modify existing regulations related to hardship distributions from retirement plans, beginning in tax year 2019, 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, which would apply retroactively to tax year 2019, state tax revenues are estimated to increase by \$200,000 in 2020-21 and by \$600,000 in 2021-22 and annually thereafter. [A technical amendment to AA 2 would be needed to accomplish this intent.]

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. [A technical amendment to AA 2 would be needed to accomplish this intent.]

Disaster-Related Distributions from Retirement Plans. 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. Unless the provision were to be adopted retroactively, Wisconsin taxpayers would be required to pay tax and a penalty on early retirement distributions. However, because the provision would be adopted prospectively beginning in tax year 2021 under the bill, no effect on state tax revenues is estimated.

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 AGI and allows the loss to be claimed either as an itemized deduction or as an increase in the standard deduction for certain qualified disasters that were declared in 2019 and 2020. Because the provision would apply prospectively beginning in tax year 2021 under the bill, no effect on state tax revenues is estimated.

College Savings (529) Plans. Beginning in tax year 2019, 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 2020-21.

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. The provision would apply for certain qualified disasters that were declared in 2019 and 2020. Because the provision would apply prospectively beginning in tax year 2021 under the bill, no effect on state tax revenues is estimated.

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 Act 231, this treatment was adopted as part of state law. However, in December, 2019, the Further Consolidated Appropriations Act of 2020 retroactively repealed this provision of the TCJA. The bill 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 beginning in tax year 2021. Adopting the sunset of this provision would reduce revenues by \$900,000 on an annual basis beginning in 2021-22.

Summary of Tax Law Changes with a Fiscal Effect. The combined effect of the preceding eight provisions would be to increase state tax collections (GPR-Tax) by \$100,000 in 2020-21 and reduce state tax collections by \$1,900,000 in 2021-22 and 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 that were signed prior to January 1, 2020, are not expected to measurably affect state tax collections. A brief description of each act follows.

Consolidated Appropriations Act of 2018. 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 2017 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 of 2018 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. 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.

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 Changes. The bill 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 of 2018 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.

Certain technical provisions in the Consolidated Appropriations Act of 2018 would also be extended retroactively to tax year 2017, along with two provisions in the BBA. The two latter 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, 2019, and 2020, the bill would extend provisions included in the BBA related to Section 179 expensing and tax extenders, the Consolidated Appropriations Act of 2018 related to various technical corrections, and the Further Consolidated Appropriations Act related to retirement and pension plans.

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 bill 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.

The other three federal acts listed above were enacted after January 1, 2020, and are therefore

generally excluded from the bill, which primarily includes changes to the IRC adopted through December 31, 2019. However, the bill would update state references to the IRC to include: (a) provisions in the Families First Coronavirus Response Act pertaining to refundable federal tax credits for qualified emergency leave (no state fiscal impact); and (b) provisions in the CARES Act which were already adopted by Wisconsin in 2019 Act 185, or relate to other federal taxes and credits that do not have a state fiscal impact.