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May 18, 2017 Joint Committee on Finance Paper #574

Homestead Tax Credit -- Inclusion of Certain Disqualified Losses in Household Income (Shared Revenue and Tax Relief -- Property Tax Credits)

[LFB 2017-19 Budget Summary: Page 416, #7]

CURRENT LAW

The homestead tax credit is an income tax credit based on a formula that takes into account a tax filer's household income and property tax or rent paid during a tax year. To qualify for the credit, a claimant must be at least 18 years or older, must own or rent his or her residence, and must have household income under the maximum income level of $24,680, regardless of whether it is earned income or not. The credit is refundable in that claimants do not need to have a tax liability or income (household income or earned income) in order to receive the credit.

For purposes of calculating the credit, household income is broadly defined to reflect most cash resources available to claimants. Claimant income starts with Wisconsin adjusted gross income (WAGI). Claimants are then required to report statutorily-specified household income "addbacks" that are subtracted from WAGI for personal income tax purposes. Also, household income is adjusted downward by $500 for each dependent to account for family size.

For claimants with income of $8,060 or less, a credit is equal to 80% of property taxes or rent constituting property taxes up to a maximum of $1,460 in property taxes or rent. Rent constituting property taxes is 25% of rent if payment for heat is not included in rent and 20% of rent if payment for heat is included. The maximum credit is $1,168.

The credit is phased out for claimants with income between $8,060 and $24,680, at which point the credit equals zero. For claimants with less than $1,460 in allowable rent or property taxes, the credit is reduced at lower income levels. The credit formula can be expressed as a mathematical equation for individuals with income between $8,060 and $24,680 as shown below:

Homestead Credit = 80% x [Property Taxes - 8.785% x (Household Income - $8,060)]

In 2015-16, homestead tax credit claims totaled $98,405,320.

GOVERNOR

Require homestead tax credit claimants to report disqualified losses in excess of $15,000 in the calculation of household income for the purposes of calculating the homestead credit. Decrease the estimated cost of the credit by $470,000 annually. Define "disqualified loss" as the sum of the following, exclusive of net gains from the sale or exchange of capital or business assets and exclusive of net profits: (a) net loss from sole proprietorships; (b) net capital loss; (c) net loss from sales of business property, excluding loss from involuntary conversions; (d) net loss from rental real estate, royalties, partnerships, tax-option S corporations, trusts, estates, and real estate mortgage investment conduits; and (e) net farm loss. This provision would not apply to a homestead credit claimant who is a farmer whose primary income is from farming and whose farming generates less than $250,000 in gross receipts in the year to which the claim relates.

DISCUSSION POINTS

1. Under AB 64/SB 30, inclusion of disqualified losses in household income for the purposes of calculating the homestead credit would first take effect for tax year 2018. However, the Department of Administration (DOA) intended the provision to take effect in tax year 2017. Consistent with DOA's intent, the budget includes a homestead tax credit expenditure reduction of $470,000 in 2017-18 and 2018-19, for a total reduction of $940,000 over the biennium to reflect that the provision would be in effect for both tax years. On April 1, 2017, DOA submitted an errata that would modify the bill to change the effective date of this proposal to tax year 2017 [Alternative 1].

2. Currently, homestead credit claimants must report their household income in order to receive the credit. For the purposes of calculating the credit, household income is broadly defined to reflect most cash resources available to claimants. Claimant income starts with Wisconsin adjusted gross income (WAGI). Claimants are then required to report a number of statutorily-specified household income "addbacks" that are subtracted from WAGI, such as unemployment compensation, capital gains, and child support. The total amount of WAGI plus the amounts of all "addbacks" is a claimant's household income for the purposes of calculating the homestead credit. The Attachment to this paper lists "addbacks" to WAGI required under current law.

3. For personal income tax purposes, current year disqualified losses have the effect of reducing a taxfiler's WAGI in that year. For the purpose of calculating the homestead credit, the Governor's proposal would require claimants to add back the amount of these disqualified losses in excess of $15,000 to WAGI in the same manner as other household income "addbacks" currently specified in statute. Adding these disqualified losses to WAGI would have the effect of increasing a claimant's household income for the purposes of determining eligibility for the homestead credit and calculating the credit amount.

4. The Governor's proposal relative to disqualified losses does not apply to homestead credit claimants who are farmers whose primary income is from farming and whose farming generates less than $250,000 in gross receipts in the year to which the claim relates. U.S. Department of Agriculture defines farms generating less than $250,000 in gross receipts as "small farms." According to the administration, excluding such claimants from the disqualified loss provision was intended to maintain the relief provided by the homestead credit for small farm claimants who are more likely to need financial assistance.

5. The Department of Revenue (DOR) estimates that approximately 500 homestead credit claimants would lose their credit under the Governor's proposal, which would result in an annual expenditure reduction of approximately $350,000. The remaining $120,000 of the total annual expenditure reduction associated with the proposal would result from approximately 360 claimants receiving a reduced credit. Such claimants would remain eligible for the credit because their reported household income would remain below the $24,680 maximum income level. However, adding back the proposed disqualified losses would effectively increase their household income, which would result in smaller credits. Under current law, credit amounts decrease for claimants as household income rises from $8,060 to the maximum allowable income of $24,680, at which point the credit equals $0.

6. AB 64/SB 30 also includes a disqualified loss provision for the Earned Income Tax Credit (EITC). This provision requires that EITC claimants report the full amount of a disqualified loss greater than $15,000. For example, if an EITC claimant has a disqualified loss of $20,000, the claimant would add $20,000 to his or her earned income for the purposes of calculating the EITC. In comparison, a homestead claimant with a disqualified loss of $20,000 would only add $5,000 ($20,000 - $15,000 = $5,000) to his or her household income for purposes of calculating the homestead credit.

7. If the Committee wants to apply disqualified losses for the purposes of calculating the homestead credit in the same manner such losses would be applied to calculating the EITC under the bill, it could require that homestead claimants add back the total amount of the disqualified loss if the loss is greater than $15,000 [Alternative 2]. This alternative would further reduce estimated credit expenditures by $280,000 annually compared to the bill ($750,000 annually compared to the base). An estimated 210 claimants would receive a reduced homestead credit, and an estimated 860 claimants would lose the homestead credit under this alternative.

8. Requiring EITC claimants to add back total losses greater than $15,000 would create a cliff effect whereby a claimant with exactly $15,000 of disqualified losses would not be required to add back any amount of the loss to his or her earned income. Conversely, a claimant with $15,001 of disqualified losses would be required to add back $15,001 to his or her earned income. Due to this cliff effect, some may contend that requiring claimants to report the amount disqualified losses in excess of $15,000, as the Governor proposes for the homestead credit, is a more effective and fair treatment of such losses because claimants would gradually transition off of the credit as the amount of disqualified losses in excess of $15,000 increases household income up to $24,680, at which the point the credit would equal $0.

9. The following table provides DOR's estimate of the percent of total disqualified losses

that each disqualified loss type makes up of the total amount of such losses that could be reported by homestead credit claimants with disqualified losses. Of the total amount of losses, the majority (40.5%) is estimated to result from net losses from rental real estate, royalties, partnerships, tax option S corporations, trusts, estates, and real estate mortgage investment conduits, followed by net losses from sole proprietorships (28.9%).

**Net Disqualified Loss Type for
Homestead Credit Claimants with Disqualified Losses**

Net Disqualified Loss	Percent of Loss Added Back
Rental real estate, royalties, partnerships, tax option S corporations, trusts, estates, and real estate mortgage investment conduits	40.5%
Sole proprietorships	28.9
Sales of business property*	20.4
Farm	8.4
Capital	1.8
Total	100%

*Excludes losses from involuntary conversions.

10. The disqualified losses included in the above table are typically related to personal business operations, which could suggest claimants with such losses may have sufficient wealth or financial resources in other years when losses are not incurred that they may not need assistance in paying their property taxes, which the credit provides. Requiring such claimants to add the full amount of disqualified losses to household income, rather than just the amount of losses in excess of $15,000, would significantly reduce or eliminate the credit for these claimants. Further, it would treat these losses in the same manner as other "addbacks" to household income are currently treated [Alternative 3]. This alternative would reduce estimated credit expenditures by $1,130,000 annually compared to the bill ($1,600,000 annually compared to the base). Approximately 6,800 claimants would receive a reduced homestead credit, and 2,000 would be estimated to lose their homestead credit under this alternative.

11. Under current law, homestead claimants are required to add back losses from other tax years (capital loss carry-forwards and net operating loss carry-forwards and carry-backs) to household income. This provision prevents claimants from reporting lower household incomes in a given year based on losses that occurred in prior years. However, the current law credit does not require claimants to add back losses in the year for which the credit is claimed, which allows for lower household income and a larger homestead credit for the year in which a loss was incurred. Some may contend that claimants with current year disqualified losses should remain eligible for the homestead credit based on the principle that the credit provides financial assistance to claimants with low income in the year for which the credit is claimed regardless of how the income level was achieved. If the Committee is concerned about maintaining this principle, it could delete the Governor's proposal [Alternative 4].

ALTERNATIVES

1. Approve the Governor's recommendation, as modified by the errata, to require homestead credit claimants to report disqualified losses in excess of $15,000 in the calculation of household income under the homestead tax credit in tax year 2017 and thereafter. This provision would have no additional impact on the estimated cost of the credit compared to the bill.

ALT 1	Change to Base	Change to Bill
GPR	- $940,000	$0

2. Modify the Governor's recommendation and require homestead credit claimants to report total disqualified losses greater than $15,000 in the calculation of household income under the homestead tax credit in tax year 2017 and thereafter. This provision would reduce the estimated cost of the credit by $280,00 annually compared to the bill.

ALT 2	Change to Base	Change to Bill
GPR	- $1,500,000	- $560,000

3. Modify the Governor's recommendation and require homestead credit claimants to report total disqualified losses in the calculation of household income under the homestead tax credit in tax year 2017 and thereafter. This provision would reduce the estimated cost of the credit by $1,130,000 annually compared to the bill.

ALT 3	Change to Base	Change to Bill
GPR	- $3,200,000	- $2,260,000

4. Delete provision (increase the estimated cost of the credit by $470,000 annually).

ALT 4	Change to Base	Change to Bill
GPR	$0	$940,000

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Attachment

ATTACHMENT

Sources of Income Included in "Household Income" Under the Homestead Tax Credit Program

Household income means Wisconsin adjusted gross income (AGI) plus the following amounts to the extent not included in Wisconsin AGI:

- Support money
- Cash public assistance (not including credits from this program or amounts granted under the community options program for long-term support) and cash benefits paid under county relief programs
- Maintenance payments (except that foster care maintenance and supplementary foster care payments are excludable)
- Gross amount of any pension or annuity
- Railroad retirement benefits
- Social security benefits
- Veterans disability pensions
- Nontaxable interest received from the federal government, or any of its instrumentalities
- Nontaxable interest received on state and municipal bonds
- Worker's compensation
- Unemployment compensation
- Gross amount of "loss of time" insurance
- Compensation and other cash benefits received from the United States for past or present services in the armed forces
- Scholarship, fellowship, or educational grants, gifts, or income
- Capital gains
- Gain on the sale of a personal residence that is excluded from taxable income
- Dividends
- Income of a nonresident or part-year resident who is married to a full-year resident
- Housing allowances provided to members of the clergy
- Amount by which a resident manager's rent is reduced
- Nontaxable income of an American Indian
- Nontaxable income from sources outside this state
- Nontaxable deferred compensation
- Intangible drilling costs
- Depletion allowances and depreciation
- Amortization
- Contributions to individual retirement accounts
- Contributions to Keogh plans
- Net operating loss carry-forwards and carry-backs
- Capital loss carry-forwards