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September 30, 2003

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: 2003 Assembly Bill 98: Creation of Individual and Corporate Income Tax Exemptions for Interest on Wisconsin Housing and Economic Development Authority Bonds Related to Multifamily and Elderly Housing Projects

2003 Assembly Bill 98 would create individual and corporate income tax exemptions for interest on bonds or notes issued by the Wisconsin Housing and Economic Development Authority (WHEDA) for purposes related to multifamily and elderly housing projects. The bill was introduced on February 20, 2003, and was referred to the Assembly Committee on Housing. That Committee adopted Assembly Amendment 1 on March 5, 2003. On the same day, AB 98, as amended, was adopted and recommended for passage by a vote of 6 to 0. After being found to be good public policy by the Joint Survey Committee on Tax Exemptions on May 28, 2003, AB 98, as amended, was adopted by the Assembly on June 4, 2003, and messaged to the Senate, where it was referred it to the Senate Committee on Economic Development, Job Creation, and Housing. On August 20, 2003, the Senate Committee recommended concurrence by a vote of 5 to 0.

CURRENT LAW

Interest earnings from WHEDA bonds are generally included in taxable income under the state's individual and corporate income taxes. However, current law provides exemptions from such taxes for interest received on bonds or notes issued by WHEDA to fund an economic development loan to finance construction, renovation, or development of property of certain professional sports and entertainment home stadiums that are exempt from property taxes. In addition, interest from bonds or notes issued by WHEDA to fund a loan for certain cultural and architectural landmarks is exempt from the individual income tax, as is the interest from certain WHEDA bonds issued prior to January 29, 1987.

SUMMARY OF BILL

AB 98 would create individual and corporate income tax exemptions for interest received on bonds or notes issued by WHEDA if the notes or bonds were issued to fund multifamily affordable housing projects or elderly housing projects. The proposed exemptions would apply to interest from such bonds or notes issued on or after the effective date of the bill (the day after publication). In addition, the bill would repeal the current law individual income tax exemption for interest from WHEDA bonds or notes issued to fund a loan for certain cultural and architectural landmarks, which is obsolete. The tax exemptions would first apply to taxable years beginning on January 1 of the year in which the bill takes effect. However, if the bill takes effect after July 31 of a year, the exemptions would first apply to taxable years beginning on January 1 of the following year.

SUMMARY OF ASSEMBLY AMENDMENT 1

Assembly Amendment 1 to AB 98 would require WHEDA to reimburse the state for tax revenue lost as a result of the proposed income tax exemptions for the first three years from the bill's effective date. Under the amendment, WHEDA would be required to pay into the state treasury by the last day of the 12th, 24th, and 36th months beginning after the bill's effective date an amount equal to the cost to the state of the proposed tax exemptions in the previous 12 months. The costs would be determined jointly by the Department of Administration and WHEDA.

FISCAL EFFECT

WHEDA has estimated that approximately $37.5 million in bonds (including refunding bonds) are issued each year related to multi-family and elderly housing projects, and that Wisconsin residents hold approximately 5% of such bonds. Most corporations are subject to the corporate franchise tax, not the income tax. Therefore, it is projected that the effect of the proposed exemptions on state tax revenues would be primarily on collections from the individual income tax. Assuming an average marginal tax rate of 6.5% and an interest rate of 5% on such bonds, it is estimated that individual income tax revenues would be reduced by $6,100 annually for new bonds issued during the year. The annual effect on tax revenues would increase each year as more bonds are issued. WHEDA estimates that the cost of the exemption would peak at $36,600 in the sixth year and then remain constant, based on an assumption that subsequent new issues would be balanced by the retirement of older bonds. Assuming an initial applicability date of January 1, 2004, it is estimated that the bill would reduce state tax revenues by $6,100 in 2004-05.

AA 1 to AB 98 is intended to defray, for three years, the cost to the state of the proposed income tax exemptions. However, due to a technical error related to the payment dates specified in the amendment, the full costs of the exemptions during the first three years to which they would apply would not be covered. The error is a result of the tax exemptions being subject to an initial applicability date (which would be January 1, 2004, for any bills passed in the current legislative session), while the payment mechanism under the amendment would refer to costs associated with a specified number of months from the effective date of the bill (rather than to the first three taxable years to which the exemptions would apply). The timing error could be corrected by an amendment to clarify that the payment by WHEDA to the State Treasury would be based on the cost of the exemption for the first three taxable years to which the exemptions applied. Assuming an amendment was adopted to make the technical correction, there would be no net fiscal effect of the bill until 2007-08. Based on WHEDA's projection that individual income tax collections would decrease by an additional $6,100 annually, as long as more bonds were issued each year, the cost to the state in 2007-08 would be an estimated $24,400. The estimated fiscal effect would increase to $30,500 in 2008-09 and $36,600 in 2009-10 and thereafter.

It should be noted that WHEDA has projected that, if an income tax exemption were available for associated interest earnings, the percentage of bonds held by Wisconsin residents could increase from the current estimate of 5% to 35%. However, the interest income from bonds held by non-residents is not currently subject to state income taxes. Therefore, there would be no loss in state tax revenue based on having a higher proportion of such bonds being held by state residents for whom the interest income would be tax-exempt.

EFFECT ON WHEDA'S GENERAL RESERVE FUND

WHEDA is a public body corporate and politic that sells taxable and tax-exempt mortgage revenue bonds and uses the proceeds to fund loans to eligible homebuyers, housing developers, and businesses at below market interest rates. The Authority is not a state agency and its operating budget is not included in the state budget and is not subject to legislative control. Revenues to finance its operating budget come from interest earnings on loans it makes, investments of its assets, and administrative fees it assesses.

WHEDA officials state that payments made to reimburse the state for tax revenue lost as a result of the proposed income tax exemption would come from WHEDA's general reserve fund. WHEDA's general reserve fund consists of the balance of WHEDA's assets and reserves in excess of liabilities (which derive primarily from income receivable and debts incurred from the sale of bonds and notes to finance its housing programs) minus restricted reserves for statutorily required bond redemption funds. The general reserve fund is a statutorily required fund that WHEDA may use: (a) for the repayment of advances from the state in accordance with the repayment agreements between the authority and the Secretary of Administration; (b) to pay all costs, expenses, and charges of financing, including fees and expenses of trustees and paying agents; (c) for transfers to WHEDA's capital reserve fund; (d) for the payment of the principal of and interest on notes or bonds issued by WHEDA when they become due whether at maturity or on call for redemption and for the payment of any redemption premium required to be paid where the bonds or notes are redeemed prior to their stated maturities, and to purchase notes or bonds; and (e) for such other corporate purposes of the Authority that WHEDA determines. At the start of 2003-04, WHEDA had a general reserve fund balance of $152,320,000.

The statutes further require that the unrestricted balance of these reserves be set aside for programs outlined in WHEDA's "Dividends for Wisconsin" plan. This plan, which is reviewed by the Governor and Legislature, specifies the amount of funding from total unencumbered general reserves that is to be allocated to single- and multifamily housing programs and economic development programs. In 2003-04, $10,055,500 is available for this plan (of which $2,375,000 will be transferred to the state's general fund under 2003 Act 33). Under the bill, as amended, the general reserve fund (and thereby the "Dividends for Wisconsin" plan) would be reduced by an estimated $6,100 in the first tax year for which the bill is effective (presumably 2004-05), $12,200 in the second year, and $18,300 in the third year.

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