



Legislative Fiscal Bureau

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TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Senate Substitute Amendment 1 to Senate Bill 268: Individual and Corporate Income and Franchise Taxes--Education Tax Credit

Senate Bill 268, which would create an education tax credit under the state individual and corporate income and franchise taxes, was introduced on October 2, 2003, and referred to the Senate Committee on Homeland Security, Veterans and Military Affairs, and Government Reform. On January 16, 2004, that Committee introduced Senate Substitute Amendment 1 to Senate Bill 268. The Committee adopted SSA 1 to SB 268 and recommended it for passage by a vote of 5 - 0. The bill was referred to the Joint Committee on Finance on January 22, 2004.

CURRENT LAW

There are several steps involved in calculating Wisconsin individual income tax liability. In brief, these steps are to: (a) determine Wisconsin adjusted gross income (AGI) by making additions and subtractions to federal adjusted gross income that are required under state law; (b) subtract the state's standard deduction and personal exemptions from AGI to compute Wisconsin taxable income; (c) apply the state's tax rate and bracket schedule to taxable income to find the gross tax amount; (d) subtract the applicable state tax credits from the gross tax amount to arrive at the net tax; and (e) determine if the state alternative minimum tax applies.

A corporation determines state income and franchise tax liability by: (a) computing gross income; (b) subtracting allowable deductions; (c) apportioning and allocating income, if necessary; and (d) applying the tax rate of 7.9% to arrive at gross tax liability. To determine net tax liability, allowable tax credits are subtracted. Corporate income and franchise tax credits are provided for Wisconsin sales taxes paid on fuel and electricity used in manufacturing (the credit will be replaced with a sales tax exemption beginning on January 1, 2006), qualified capital and noncapital research expenses, contributions to the Wisconsin Housing and Economic Development Authority, certain

expenses to rehabilitate historical structures, and for certain economic activities in development, enterprise development, development opportunity, agricultural development, and technology zones.

Currently, state individual income and corporate income and franchise tax laws conform to an employer educational assistance exclusion provided under federal law. With some restrictions, the federal provision allows employers to exclude from an employee's wages up to \$5,250 of educational assistance provided to the employee under a qualified educational assistance program. Under certain conditions, the exclusion can be extended to former employees and to amounts exceeding \$5,250. In addition, the state allows individual income tax filers to deduct from income up to \$3,000 in higher education tuition expenses per student per year. The deduction is phased out starting at federal AGI of \$50,000 for single taxpayers, \$80,000 for married-joint filers, and \$40,000 for married taxpayers filing separately. The deduction is completely eliminated when federal AGI reaches \$60,000 for single filers, \$100,000 for married-joint taxpayers, and \$50,000 for married-separate taxpayers.

SUMMARY OF SUBSTITUTE AMENDMENT

Senate Substitute Amendment 1 to Senate Bill 268 would create a tax credit under the state individual and corporate income and franchise taxes equal to the following:

- a. 50% of the tuition that the claimant paid or incurred during the tax year for an individual to participate in an education program of a qualified postsecondary institution, if the individual was enrolled in a degree-granting program; and
- b. 75% of the tuition that the claimant paid or incurred during the tax year for an individual to participate in an education program of a qualified postsecondary institution, if the individual was enrolled in a degree-granting program, and if the individual's taxable income in the year prior to that in which the individual began participation in the degree-granting program was 185% of the poverty line. Taxable income would be Wisconsin adjusted gross income minus the sliding scale standard deduction and allowable exemptions for the taxpayer, spouse and dependents.

The tax credit would not be refundable, but unused credits could be carried forward up to fifteen years to offset future tax liabilities. Credits could not be claimed for any tuition amounts excluded from income for the Wisconsin tuition expense deduction or the federal employer educational assistance exclusion. Eligible claimants would include sole proprietors, partners, members of limited liability companies (LLCs), S corporation shareholders, corporations, and insurance companies.

Corporations and insurance companies could claim the education tax credit to offset tax liabilities. Partnerships, S corporations, and LLCs could not claim the tax credit, but eligibility for the credit and the amount of credit that could be claimed would be based on the tuition paid by the entity. A partnership, LLC, or S corporation would be required to compute the amount of tax credit

that each of its partners, members, or shareholders could claim and to provide that information to them. Partners, members of LLCs, and shareholders of S corporations could claim the education tax credit in proportion to their ownership interest.

In order to claim an education tax credit a taxpayer would be required to do the following:

a. Obtain written certification from a qualified postsecondary institution of the amount of tuition that the taxpayer paid or incurred during the tax year for an individual to participate in an education program of the institution, and include a copy of the certification with the taxpayer's return.

b. Where necessary, obtain written certification from a qualified postsecondary institution that the taxable income of the individual for whom the taxpayer has paid or incurred tuition for the individual to participate in an education program of the institution is not more than 185% of the poverty line for the tax year, and include a copy of the certification with the taxpayer's return. In cases where an individual for whom a taxpayer claims an education tax credit is claimed as a dependent on another person's tax return, the individual's income would be the taxable income of the person on whose return the individual was claimed as a dependent.

c. Certify to the Department of Revenue (DOR) that the taxpayer will not be reimbursed for any amount of tuition for which a tax credit is claimed.

A taxpayer could not claim an education tax credit for any tuition amounts that the claimant paid or incurred for the taxpayer's family member or a family member of a managing employee unless all of the following applied:

a. The family member was employed an average of at least 20 hours a week as an employee of the claimant, or the claimant's business, during the one-year period prior to commencing participation in the education program for which the taxpayer claims the credit.

b. The family member is enrolled in a degree-granting program that is substantially related to the taxpayer's business.

c. The family member is making satisfactory progress towards completing the degree-granting program.

"Degree-granting program" would be defined as an educational program for which an associate, a bachelor's, or a graduate degree is awarded upon successful completion. "Qualified postsecondary institution" would mean a University of Wisconsin System institution, a technical college system institution, a regionally accredited four-year nonprofit college or university having its regional headquarters and principal place of business in Wisconsin, or a school approved by the veterans educational approval board, if that school has a physical presence and delivery of education occurs in Wisconsin. "Managing employee" would be an individual who wholly or

partially exercises operational or managerial control over, or who directly or indirectly conducts, the operation of the claimant's business.

DOR would administer the education tax credit and current law provisions related to change of business or ownership and timely claims would apply to the credit. In addition, DOR would be required to biennially submit a report to the chief clerk of each house of the Legislature that would identify each qualified postsecondary institution for which it has received written certification of eligible education tax credit tuition having been paid, and that would specify the total amount of tuition for each such institution that was claimed as a credit in the previous biennium.

The education tax credit would first apply to tax years beginning on or after January 1, 2006.

FISCAL EFFECT

The fiscal estimate of the education tax credit was developed by the Department of Revenue and is based on information from the University of Wisconsin System, the Wisconsin Technical College System, and the U.S. Office of Management and Budget. Based on this information, it is estimated that the education tax credit would reduce state individual and corporate income and franchise tax revenues by \$18.0 million, annually. Since the credit would first apply to tax years beginning on or after January 1, 2006, there would be no fiscal effect during the 2003-05 biennium. However, beginning with fiscal year 2006-07, annual state income and franchise tax revenues would be reduced by an estimated \$18.0 million. The \$18 million figure is based on estimates of employer-provided educational assistance under current law. A larger revenue loss would occur if the credit encourages businesses to provide additional amounts of educational assistance to their employees.

In the fiscal note to Senate Bill 268, DOR indicates that it would incur one-time computer programming costs of \$48,100 and annual computer support and data capture costs of \$51,100. However, neither SB 268 nor SSA 1 to SB 268 provides DOR with additional funding for administrative costs.

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