Legislative Fiscal Bureau
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April 7, 2010

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 749: Individual Income and Corporate Income and Franchise Taxes -- Woody Biomass Harvesting and Processing Tax Credit

Assembly Bill 749, which would create a woody biomass harvesting and processing tax credit under the state individual income and corporate income and franchise taxes, was introduced on February 15, 2010, and referred to the Assembly Committee on Forestry. On March 3, 2010, that Committee recommended Assembly Amendments 1 and 2 for adoption by votes of 5 to 0. AB 749, as amended, was then recommended for passage by a vote of 5 to 0, and referred to the Joint Committee on Finance.

CURRENT LAW

Under current law, capital assets used in a trade or business are usually depreciated. The deduction for depreciation allows taxpayers to recover, over a period of years, the cost of capital assets used in a trade or business or for the production of income. Because state depreciation provisions are referenced to the Internal Revenue Code (IRC) in effect on December 31, 2000, tangible depreciable property currently placed in service is generally subject to the federal Modified Accelerated Cost Recovery System (MACRS). Specifically, the cost of eligible property is recovered over a 3, 5, 7, 10, 15, 20, 27.5, 31.5, 39, or 50-year period depending upon the type of property involved. Depreciation methods are prescribed for each MACRS class. Generally, personal property is assigned to the three-year class, the five-year class, the seven-year class, or the 10-year class. Real property is assigned to the remaining classes based on the type of property involved. Property included in the three-year, five-year, seven-year, and 10-year classes is depreciated using the double declining balance method, switching to the straight-line method at a time which maximizes the depreciation allowance. Property in the 15-year and 20-year classes is depreciated using the 150% declining balance method, again switching to the straight-line method at a time which maximizes the depreciation allowance.

Under Section 179 of the IRC, a taxpayer may elect to treat all or a portion of the cost of qualifying property, up to a limit, as an expense rather than as a capital expenditure. Such an expense or cost is deductible in the year in which the property is placed in service. Federal section 179 provisions enacted since 2003 have not been adopted for state income and franchise tax purposes for non-farm property. Rather, state taxpayers are generally subject to Section 179 IRC provisions that were in effect for tax years through 2002. As a result, under current Wisconsin law, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property (except for property used in farming) in the year it is placed in service rather than taking depreciation deductions over a specified recovery period. In general, qualifying property is depreciable tangible personal property that is purchased for the active conduct of a trade or business. The maximum deductible amount of $25,000 is reduced (but not below zero) by the amount by which the qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a tax year may not exceed the taxable income of the taxpayer that is derived from the active conduct of a trade or a business for that year. Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding years and deducted, subject to the total investment and taxable income limits. The $25,000 expense limit also applies to vehicles weighing between 6,000 and 14,000 pounds.

Current state law is referenced to the Section 179 provisions included in the federal Tax Increase Prevention and Reconciliation Act of 2005, for property that is used in farming that is acquired and placed in service in tax years beginning on or after January 1, 2008, and used by a person who is actively engaged in farming. Under the Act, the maximum amount that could be expensed was $100,000, and the investment limit was $400,000. Both the maximum expense deduction and investment limit were indexed for inflation. Consequently, for state income and franchise tax purposes, for the 2009 state tax year, the maximum amount that can be expensed is $120,000, and the investment limit is $480,000, for eligible property used in farming.

The terms "farming" and "actively engaged in farming" are referenced to federal law. "Farming" means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. Trees, other than trees bearing fruit or nuts, are not treated as an agricultural or horticultural commodity.

"Actively engaged in farming" means that the individual or entity independently makes a significant contribution to a farming operation of: (a) capital, equipment, or land, or a combination of capital, equipment, or land; and (b) active personal labor or active personal management, or a combination of active personal labor and active personal management. In determining if the individual or entity is actively contributing a significant amount of active personal labor or active personal management, the following factors must be considered: (a) the types of crops and livestock produced by the farming operation; (b) the normal and customary farming practices of the area; and (c) the total amount of management and labor necessary for such a farming operation in the area. In order to be actively engaged in farming, the individual or entity must have: (a) a share of the profits or losses from the farming operation; and (b) contributions to the farming operation that are at risk.

SUMMARY OF BILL

AB 749 would create a refundable woody biomass harvesting and processing tax credit, under the state individual income and corporate income and franchise taxes, equal to 10% of the amount the claimant paid in the tax year for equipment that is used exclusively to harvest or process woody biomass that is used for fuel or as a component of fuel. The credit could be claimed for tax years beginning after December 31, 2008, and before January 1, 2015.

The maximum aggregate amount of tax credits that could be claimed by a taxpayer would be $100,000, and a credit could not be claimed for expenses that were deducted as trade or business expenses. If two or more persons owned and operated a woody biomass harvesting or processing operation, each person could claim a tax credit in proportion to his or her ownership interest, except that the aggregate amount of credits claimed by all the persons who owned and operated the woody biomass processing operation could not exceed the $100,000 aggregate tax credit limit. (The $100,000 aggregate tax credit limit would apply to partnerships, limited liability companies [LLCs], and tax-option corporations [S-corporations].) If the allowable credit claim exceeded the taxes otherwise due on the claimant's income, the amount of credit claim that was not used to offset tax due would be certified by the Department of Revenue (DOR) to the Department of Administration for payment by check, share draft, or other draft from a GPR sum sufficient appropriation that would be created under the bill. The total amount of tax credits that could be claimed by all taxpayers would be limited to $900,000 for each state fiscal year.

Partnerships, LLCs, and tax-option corporations could not directly claim the tax credit, but eligibility for, and the amount of the credit that could be claimed, would be based on the entity's payment of eligible expenses, subject to the $100,000 limit on the aggregate amount of tax credits that a taxpayer could claim. A partnership, LLC, or tax-option corporation would be required to compute the amount of the credit that each of its partners, members, or shareholders could claim and provide that information to them. Partners, members, and shareholders, then could claim the credit in proportion to their ownership interest.

The Department of Commerce would be required to certify taxpayers as eligible for the woody biomass harvesting and processing tax credit. Once Commerce certified a taxpayer as eligible for the tax credit, it would determine the amount of credits that a taxpayer could claim, and allocate those credits to the taxpayer. Commerce would be required to inform DOR of every taxpayer that was certified, and of the amount of credits allocated to the taxpayer. Commerce, in consultation with DOR, would be required to promulgate rules to administer the certification and allocation process. DOR would administer the tax credit, and current law provisions related to change of ownership and timely claims would apply to the woody biomass harvesting and processing tax credit.

"Woody biomass" would mean trees and woody plants, including limbs, tops, needles, leaves, and other woody parts, grown in a forest or woodland or on agricultural land. "Used exclusively" would mean used to the exclusion of all other uses, except for use not exceeding 5% of total use.

ASSEMBLY AMENDMENT 1

AA 1 would make the following modifications to AB 749:

a. The tax years for which the woody biomass harvesting and processing tax credits could be claimed would be delayed one year. Tax credits could be claimed for tax years beginning after December 31, 2009 (rather than 2008), and before January 1, 2016 (rather than 2015).

b. The credit could be claimed for amounts paid for equipment used "primarily" (rather than "exclusively") to harvest or process woody biomass used for fuel or as a component of fuel.

c. "Used primarily" would mean used to the exclusion of all other uses, except for use not exceeding 25% of total use.

ASSEMBLY AMENDMENT 2

AA 2 to AB 749 would require Commerce to allocate $450,000 of the total annual credit allocation to businesses that, individually, have no more than $3 million in Wisconsin adjusted gross income for the tax year in which the credit was claimed.

FISCAL EFFECT

Assembly Bill 749. Based on information from the 2006 Census of Manufacturing compiled by the U. S. Census Bureau, and on data related to logging company operations and investments provided by representatives of the forestry industry and other related associations and organizations, staff at the University of Wisconsin Forestry Extension, and staff at the Department of Natural Resources, it is estimated that a woody biomass harvesting and processing tax credit would increase state GPR expenditures by $900,000 in 2009-10 through 2014-15. The credit would increase GPR expenditures because it is refundable. Under AB 749, the tax credit first applies to tax years beginning in 2009. It is likely that the $900,000 in credit claims for 2009-10 would be claimed through amended returns filed for future fiscal years.

AB 749 would require the Department of Commerce to establish and administer a process for certifying taxpayers as eligible for woody biomass harvesting and processing tax credits, and for allocating credits to taxpayers. Commerce would also be required to promulgate administrative rules to for this process. No additional positions or funding are provided to Commerce for these additional administrative responsibilities. However, Commerce indicates it would require 1.0 position and $73,400 GPR annually to administer and write rules for the certification and allocation program.

Assembly Amendment 1. AA 1 would delay the effective date for the tax credit to apply to tax years 2010 through 2015. Consequently, the fiscal effect would shift $900,000 in GPR expenditures from fiscal year 2009-10 to 2015-16.

On January 27, 2010, this office issued a memorandum regarding the status of the state's general fund. At that time, the gross balance of the general fund, as of June 30, 2011, was estimated at $55.7 million, or $9.3 million below the $65.0 million balance required under s. 20.003(4) of the state statutes. As a result, an amendment would be needed to include a notwithstanding clause relative to s. 20.003(4).

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