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February 8, 2018

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: January 2018 Special Session Assembly Bill 5 and Senate Bill 5: Pilot and Permanent Program for Certain Claimants of the Earned Income Tax Credit

January 2018 Special Session Assembly Bill 5 (SS AB 5) and Special Session Senate Bill 5 (SS SB 5) were both introduced on January 26, 2018 at the request of the Governor. On the same day, SS AB 5 was referred to the Assembly Committee on Public Benefit Reform and a public hearing was held. SS SB 5 was referred to the Senate Committee on Public Benefits, Licensing, and State-Federal Relations, which held a public hearing on the bill on January 31, 2018. Both bills are scheduled for executive session by the respective committees on Tuesday, February 6.

CURRENT LAW

State law confers a variety of powers and duties on the Department of Revenue (DOR) related to state and local taxation. This includes the administration of the state individual income tax, on which filers may claim state tax credits that may be either refundable or nonrefundable.

The earned income tax credit (EITC) is offered at both the state and federal levels as a means of providing assistance to lower-income workers. The credit provides a supplement to the wages and self-employed income of such families and is intended to offset the impact of other taxes and increase the incentive to work. Both the federal and Wisconsin credits are refundable, so individuals with little or no income tax liability may still receive the credit.

The federal EITC is generally based on earned income, but can be affected by adjusted gross income (AGI). The formula for determining credit amounts uses three income thresholds and credit percentages, or credit rates, that are based on the claimant's number of children -- 7.65% if no children, 34.00% if one child, 40.00% if two children, and 45.00% if three or more children. For claimants whose only income is earned income, the credit is calculated as a percentage of earned income up to certain thresholds. The credit gradually increases until earned income reaches the first threshold amount, at which a claimant receives the maximum allowable credit. This income threshold is called the maximum credit income. Claimants are eligible for the maximum credit if their earned income falls between this threshold and the second income threshold, called phase-out income. When claimants' income exceeds the phase-out income threshold, their credit is reduced by multiplying their income exceeding the phase-out income threshold by a phase-out rate and by subtracting the result from the maximum credit. The third income threshold, called the maximum income level, is the level at which the credit is eliminated.

Claimants with unearned income in addition to earned income calculate their initial credit using earned income, but calculate the phase-out using the greater of earned income or AGI. The parameters for calculating credits vary by filing status and by number of children. The income thresholds are adjusted each year for changes in inflation, while the credit percentages and phase-out rates remain the same from year to year.

The state EITC is calculated as a percentage of the federal credit and is claimed on Wisconsin's individual income tax form. The state tax credit percentages are 4% for claimants with one child, 11% for claimants with two children, and 34% for claimants with three or more children. Unlike the federal credit, the Wisconsin credit is not available to individuals with no children.

Previously, advanced payment of the federal EITC was authorized through payroll withholding, but was discontinued in 2010. In 2009 Wisconsin Act 28, Wisconsin adopted an advanced payment provision for the state EITC, but those payments were contingent on receiving advanced federal payments. Consequently, advanced state credit payments are no longer permitted.

SUMMARY OF BILLS

The bills would authorize DOR to conduct a two-year pilot program that studies federal EITC recipients, with assistance from the Internal Revenue Service (IRS). Conducting the pilot program would be contingent on the two agencies entering into an agreement that describes the responsibilities and duties of each agency. The study would involve two groups of 100 randomly selected federal EITC recipients, who are likely to receive the credit in tax years 2019 and 2020. The bills specify that the participants in each group remain the same, to the greatest extent possible.

For the first group, DOR and the IRS would select claimants whose credit would likely exceed $600 each year, based on an IRS determination of likely credit amounts. At the beginning of each tax year, the IRS would forward DOR the likely credit amounts for each individual in the first group. DOR would deposit the amounts in the state general fund and disburse the amounts from an appropriation created by the bills to each claimant on an advanced, periodic basis. The second group of likely 2019 and 2020 federal EITC claimants would not receive their credits on a periodic basis. Rather, they would continue to claim their credits by filing federal income tax returns.

For the first group of likely recipients, DOR would make the advance payments monthly, and payments would equal one-eleventh (9.1%) of the claimant's likely federal credit, except total annual disbursements could not exceed two-thirds (66.7%) of the claimant's likely credit amount.

Each year, the state would make a final payment by check to the recipient in the month after the month that the recipient claims his or her federal credit. If the amounts received from the state are less than the amount of the federal credit for which the claimant is eligible, the claimant could claim the difference on his or her federal income tax return or the difference could be claimed through any other mechanism specified in the DOR-IRS agreement. Individuals would claim their state EITC under provisions currently specified in state law.

DOR would be required to compare the financial stability of claimants in the first group to claimants in the second group. In addition, DOR would be authorized to develop policies and promulgate rules to ensure that members of each group would be able to continue to claim the state EITC so long as they are eligible for the credit.

If the IRS and DOR are able to reach an agreement describing the responsibilities and duties of each agency and how the program would operate, DOR would be required to make the program permanent and applicable to all eligible claimants of the state EITC, beginning in tax year 2021. If no agreement is reached on how the program would operate, the program would not be made permanent and would not be extended to claimants of the state EITC.

FISCAL EFFECT

The bills would authorize DOR to receive and expend federal funds for purposes of making advance payments of federal EITC amounts. However, the receipt and expenditure of those funds is contingent upon the IRS entering into an agreement with DOR for that purpose. Staff at the Department of Administration are not aware of any authority for the IRS to enter into such an agreement. If authority is granted and an agreement is reached, DOR would be required to conduct a study comparing the fiscal stability of 100 individuals in a test group receiving federal EITC payments on an advanced basis to 100 individuals in a second test group who receive federal EITC payments after filing their federal tax returns. The bills do not provide funding for the administrative costs of conducting the study, but DOR indicates it would incur such costs. Since an agreement with the IRS detailing the responsibilities of each party has not been reached, the cost of the study is unknown. However, DOR suggests that the study's cost could be $232,000, which includes $32,000 for interviewing study participants and $200,000 for computer software development and analysis of the resulting data.

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