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Tax Relief Fund Tax Credit
(Budget Management and Compensation Reserves and General Fund Taxes -- Individual and Corporate Income Taxes)

[LFB 2001-03 Budget Summary: Page 20, #1 and Page 154, #4 (part)]

CURRENT LAW

Under current law, the state provides certain credits that may be applied against a taxpayer's gross state income tax liability. Commonly used credits include the property tax/rent credit, the married couple tax credit, the itemized deduction tax credit and the working families tax credit. In each case, the formula for determining a taxpayer's credit is specified in the statutes and is based on certain factors related to the taxpayer's income or expenditures.

GOVERNOR

Create a nonrefundable individual income tax credit for the purpose of returning moneys from the tax relief fund to taxpayers when the fund exceeds $25 million.

Under the bill, certain moneys would be deposited to the tax relief fund in the event that actual general fund tax revenues exceeded estimated collections. The provisions pertaining to the transfer of monies to the tax relief fund are discussed in Issue Paper #241.

The bill would provide that, no later than September 1 of each year, the Secretary of the Department of Administration (DOA) would certify to the Secretary of the Department of Revenue (DOR) the amount in the tax relief fund. If the certified amount exceeded $25 million, DOR would be required to determine a tax relief fund tax credit amount that could be claimed by taxpayers for the taxable year. No tax relief fund credit would be available for a year in which the certified amount were $25 million or less.

For example, under these provisions, DOA would certify to DOR by September 1, 2002, the amount, if any, in the tax relief fund. If the certified amount exceeded $25 million, DOR would determine the tax relief fund tax credit that could be claimed by taxpayers when filing returns for tax year 2002 (due in April, 2003). If the certified amount in the tax relief fund on September 1, 2002, were less than $25 million, no tax relief fund credit would be available to taxpayers for tax year 2002.

Under the bill, in a year for which a tax relief fund tax credit were to be made available to taxpayers, DOR would be required to divide the total certified amount in the fund by the sum of all claimants (taxpayers), spouses of claimants (in the case of joint returns) and claimants' dependents to determine a credit per unit. (However, no credit could be claimed on tax returns filed by individuals who are dependents of other taxpayers.) The bill would direct DOR to modify the credit per unit so that as much of the total certified amount would be expended as possible. In addition, the bill would require the unit amount to be rounded down to the nearest whole dollar. No later than August 15 of the year following a year for which there has been a tax relief fund credit, DOR would be required to determine and certify to the Secretary of DOA the amount of revenue lost because of such credits claimed against individual income taxes.

With certain exceptions, no credit would be allowed unless it was claimed within four years of the unextended due date of the individual income tax return for the taxable year in which a tax relief fund credit was available. Part-year residents and nonresidents would not be eligible for the credit. The bill would provide that income tax provisions under Chapter 71 of the statutes relating to assessments, refunds, appeals, collection, interest and penalties would apply to the tax relief fund tax credit. DOR would be authorized to enforce the credit and take any action and conduct any proceeding as otherwise authorized under Chapter 71.

The provisions on the tax relief fund tax credit would first apply to taxable years beginning on January 1 of the year in which the bill generally takes effect, unless the bill's general effective date is after July 31. In that case, these provisions would first apply to taxable years beginning January 1 of the following year. No fiscal effect is estimated because the credit would be provided only if actual general fund tax revenues significantly exceeded estimates.

DISCUSSION POINTS

1. In an attempt to control the growth of state government, numerous states have adopted revenue and/or expenditure limits. The most common types of limits are expenditure limits, which are sometimes linked with a mechanism to provide taxpayer refunds. Some states impose revenue limits, which tie yearly increases in revenue to personal income or another type of growth index. Many of the states that impose revenue and/or expenditure limits have procedures requiring that some or all of the excess is to be deposited to a budget stabilization or rainy day fund or used for some other specific purpose (such as education or infrastructure) and is only to be returned to taxpayers once the fund has reached a specified level. Provisions for returning excess revenue to taxpayers include tax rebates, individual income tax credits, and revisions to tax rates and fees.

2. Under the bill, a tax relief fund tax credit would be provided as a nonrefundable credit against the individual income tax. (The mechanism for depositing moneys in the tax relief fund is described in Issue Paper #241). The Department of Revenue would divide the total available for the credit by the estimated number of claimants (taxpayers), spouses of claimants (in the case of joint returns) and dependents to determine the per person credit amount.

3. The tax relief fund tax credit would be triggered if the amount in the tax relief fund were certified to be $25 million or more. Based on simulations with the 1999 Wisconsin tax sample, at $25 million, the estimated credit amount per person would be $6 and would result in an average tax reduction of approximately $14 for 1.7 million tax filers. The benefits to taxpayers would be fairly evenly distributed, with the greatest concentration of benefits in the middle-income ranges (which corresponds to the greatest concentration of taxpayers).

4. One advantage of the proposed credit is that the administrative cost would be small, since the credit could be incorporated into the regular income tax filing process. DOR estimates that it would cost $55,500 (in 2002-03 dollars) to make the credit available in a given year. In addition, there would be one-time development costs estimated at $26,400 the first time that the credit was made available. The administration did not include provisions on how to pay for administrative costs, under the assumption that either: (a) the credit would not be made available during the 2001-03 biennium, so there would be no cost; (b) DOR would be able to absorb such costs; or (c) DOR would submit a request to the Joint Committee on Finance under s.13.10 for supplemental funding to cover those administrative costs that could not be absorbed.

5. It could be argued that a tax credit to return excess revenue to Wisconsin residents should be designed in a manner so that all residents benefit. Under a nonrefundable credit, lower-income state residents without an income tax liability would be ineligible for the credit (even though such residents pay other state taxes, such as the sales tax). If the credit were refundable, however, all Wisconsin residents would receive a benefit. One option would be to provide a refundable credit based on the number of dependents (similar to the nonrefundable credit proposed under the bill). It is estimated that a refundable credit based on $25 million in the tax relief fund would result in a per person credit of $4. It is projected that approximately 2.9 million applicants (including tax filers and other applicants not required to file taxes) would receive an average credit of $9. In contrast, the nonrefundable credit provided under the bill would provide an average benefit of $14 to an estimated 1.7 million tax filers.

6. The administrative cost of a refundable credit would be somewhat greater than the cost for a nonrefundable credit, as there would be additional expenses for processing returns and issuing refunds. DOR estimates that it would cost $138,100 (in 2002-03 dollars) to administer a refundable credit (each year for which the credit was available), with an additional one-time development cost of $26,400.

7. State income taxes may be claimed as itemized deductions for federal income tax purposes. State sales taxes are not deductible. Therefore, for itemizers, tax relief provided through the state income tax may result in increased federal income taxes.

8. An alternate approach that would avoid this effect on federal taxes would be to provide a tax relief fund tax credit in the form of a sales tax rebate. Because sales taxes paid are not deductible for federal tax purposes, a refund of sales taxes paid is not considered to be taxable income by the federal government. The State of Colorado, which is required by the state constitution to return budget surpluses to the citizens, did so in the form of a state sales tax refund for tax years 1999 and 2000. The Colorado refunds were issued primarily through the individual income tax return. For eligible recipients that were not required to file a Colorado individual income tax form, the refund could be claimed on a separate form also used for another refundable state credit.

9. The Colorado method of returning excess revenues to taxpayers in the form of a sales tax rebate through the individual income tax form could be adopted for use with the proposed tax relief fund tax credit. A sales tax rebate modeled on the rebate offered by Wisconsin under 1999 Wisconsin Act 10 would address two concerns mentioned previously: (a) that the return of excess state revenues should benefit all taxpayers; and (b) that the refund of excess state tax revenues should not result in an increased federal tax liability. In order to be considered a rebate of sales tax paid, the rebate would have to be made available to nonresidents that applied for the rebate and had proof as to taxes paid. [The amount rebated to nonresidents as a result of Act 10 was minimal.] If the rebate were modeled after the Act 10 rebate, it would also be made available to: (a) dependents claimed on another person's return (with certain limitations); and (b) residents and part-year residents who were married to nonresidents [based on their Wisconsin adjusted gross income (AGI)]. DOR has projected that the administrative costs of a sales tax rebate would be comparable to the costs for a refundable credit that was based on number of dependents. Such costs would be lower than the costs of the sales tax rebate under Act 10, as most refunds could be provided in conjunction with individual income tax filings, so that fewer checks and less additional processing would be required.

10. Under Act 10, a taxpayer's AGI was used as an indicator of sales taxes paid and was used to determine the rebate amount. The total rebate was approximately $700 million, with an average rebate of $271. Based on this information, it is projected that a total rebate of $25 million would provide an average rebate of approximately $9 to 2.9 million applicants. This average is comparable to the average for a refundable credit based on the number of dependents. However, the sales tax rebate would be higher for higher-income applicants and lower for lower-income applicants.

11. Under each of the options discussed above, the estimated per unit credit would be quite small if the credit were provided when the total in the tax relief fund were $25 million. One could argue that it would be reasonable to set a higher threshold for providing the credit, whether the credit was refundable or not and whether the credit was based on dependents or on AGI or some other factor.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to provide a nonrefundable tax relief fund tax credit for a tax year in which DOA certified by September 1 of that year that moneys in the tax relief fund exceeded $25 million. Specify that the per person credit amount would be determined by DOR, based on the total available in the fund and, for the estimated number of filers with an income tax liability, the estimated total number of: (a) claimants [taxpayers]; (b) spouses of claimants, in the case of a joint return; and (c) dependents of claimants.

2. Modify the Governor's recommendation to specify that the credit would be made available if the amount in the tax relief fund were certified to exceed one of the following:

a. $100 million (with an estimated average credit of $57 per tax filer).
b. $250 million (with an estimated average credit of $144 per tax filer).
c. $500 million (with an estimated average credit of $288 per tax filer).
d. Some other amount.

It is estimated that a credit in this form would provide a tax reduction for 1.7 million tax filers. However, the actual credit would depend on the total number of units (taxpayers, spouses and dependents) per filer.

3. Modify the Governor's recommendation to specify that the tax relief fund tax credit would be a refundable credit. Provide that the credit would be available for a tax year in which DOA certified by September 1 that moneys in the tax relief fund exceeded a specified threshold. In addition, specify that the unit credit amount determined by DOR would be based on the amount in the tax relief fund as certified by DOA and the estimated number of Wisconsin residents [rather than taxpayers, spouses and dependents, as under the bill]. Require DOR to administer the credit in a manner similar to the homestead credit (which is also refundable and can be claimed when filing individual income taxes or through a separate schedule if no income tax form is required). Specify that the credit would be available for a tax year in which the amount in the tax relief fund, as certified by DOA to DOR, exceeded one of the following:

a. $25 million (with an estimated average credit of $9 per applicant)
b. $100 million (with an estimated average credit of $35 per applicant).
c. $250 million (with an estimated average credit of $87 per applicant).
d. $500 million (with an estimated average credit of $174 per applicant).
e. Some other amount.

It is estimated that a credit in this form would provide a tax reduction for 2.9 million applicants (including tax filers and other applicants not required to file taxes). However, the actual amount received would vary with the number of individuals per application.

4. Modify the Governor's recommendation to provide that the tax relief fund tax credit would be a refundable credit in the form of a sales tax rebate. Provide that the credit would be

available for a tax year in which DOA certified by September 1 of that year that moneys in the tax relief fund exceeded a specified threshold. Require DOR, in a year for which the credit is to be made available, to develop a proposal for implementing the credit as a sales tax rebate to submit by September 15 to the Joint Committee on Finance under a 14-day passive review process. In addition, direct DOR to: (a) model the rebate proposal after the rebate provided under Act 10 with respect to eligibility requirements, limitations and conditions; (b) return the rebate using the individual income tax form, when possible or through another means for individuals not required to file individual income taxes [for example, the schedule for the homestead credit could be adapted to accommodate the sales tax rebate as well as the homestead credit]; and (c) include in the proposal a schedule for the size of the rebate by filing status and Wisconsin AGI. Finally, provide that the credit would be available for a tax year in which the amount in the tax relief fund as certified by DOA to DOR exceeds one of the following:

a. $25 million (with an estimated average rebate amount of $9).
b. $100 million (with an estimated average rebate amount of $35).
c. $250 million (with an estimated average rebate amount of $87).
d. $500 million (with an estimated average rebate amount of $174).
e. Some other amount.

It is estimated that a credit in this form would provide a tax reduction for 2.9 million applicants (including tax filers and other applicants not required to file taxes). However, the actual amount received would vary with the recipient’s AGI.

In each of the alternatives outlined above, the estimated average credit is based on the assumption that the total credit would be the same amount as the specified threshold. However, the actual amount in the tax relief fund could exceed the threshold, in which case the total and average credits would exceed the estimates provided. For example, if the threshold were $25 million and the certified amount in the tax relief fund were $50 million, the total credit provided would be $50 million (and the average credit would be higher than the estimates shown for alternatives at the $25 million threshold).

There are no estimated fiscal effects provided for any of the alternatives for the 2001-03 biennium, as the tax relief fund tax credit would only be provided in the event that the moneys in the tax relief fund reached the specified minimum amount.

5. Maintain current law.

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