



## Legislative Fiscal Bureau

One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873  
Email: [fiscal.bureau@legis.wisconsin.gov](mailto:fiscal.bureau@legis.wisconsin.gov) • Website: <http://legis.wisconsin.gov/lfb>

---

May 27, 2015

Joint Committee on Finance

Paper #314

### **Internal Revenue Code Update (General Fund Taxes -- Income and Franchise Taxes)**

[LFB 2015-17 Budget Summary: Page 174, #4]

---

#### **CURRENT LAW**

State individual income tax and corporate income and franchise tax provisions are generally referenced to definitions under federal law. With limited exceptions, changes to federal law take effect for state purposes only after action by the Legislature. Generally, the Legislature reviews the previous year's federal law changes each year to update state references to the Internal Revenue Code (IRC). Under current law, state tax references generally refer to the IRC in effect as of December 31, 2010, as well as select federal provisions enacted in 2011 and 2012.

#### **GOVERNOR**

Update statutory references to the Internal Revenue Code under the state individual and corporate income and franchise taxes. For tax years beginning after December 31, 2013, create provisions adopting IRC provisions in effect as of December 31, 2013, with exceptions. Also, for tax years beginning after December 31, 2013, adopt IRC provisions included in the following public laws that were enacted after December 31, 2013: (a) P.L. 113-97, the Cooperative and Small Employer Charity Pension Flexibility Act; (b) P.L. 113-159, the Highway and Transportation Funding Act of 2014; and (c) P.L. 113-168, the Tribal General Welfare Exclusion Act of 2014. Specify that the provisions of federal public laws that directly or indirectly affect the IRC apply for state tax purposes at the same time as for federal tax purposes. Modify provisions relating to tax years beginning before January 1, 2014, to include IRC modifications made in P.L. 113-168, and repeal obsolete provisions pertaining to tax years beginning after December 31, 2002, and before January 1, 2004.

P.L. 113-97 pertains to a definition, rules, and funding standards for cooperative and small

employer charity pension plans. P.L. 113-159 pertains to minimum funding requirements for single-employer defined benefit pension plans. P.L. 113-168 clarifies the treatment of general welfare benefits provided by Indian tribes. Under the budget bill, the P.L. 113-168 provisions would extend to tax years beginning after December 31, 2013, and would also apply to tax years 2009 through 2013. The provisions would be made retroactive because they clarify current law treatment.

The Department of Revenue (DOR) indicates that the pension provisions in P.L. 113-97 and P.L. 113--159 would have a minimal fiscal effect (less than \$1,000). No fiscal estimate is reported relative to the other provisions that would be adopted.

## **DISCUSSION POINTS**

1. State references to federal law generally provide greater simplicity for taxpayers in preparing returns and reduce the administrative burden and cost for both taxpayers and DOR in assuring compliance with tax laws. The IRC references are used to determine which items of income are subject to taxation prior to specific state modifications. The state uses separate tax rates and brackets and separate provisions regarding standard deductions, personal exemptions, itemized deductions, and tax credits. Each of the three provisions enacted after December 31, 2013, that would be referenced in state law and included for state tax purposes is described in greater detail in this paper. After their description, this paper presents information on select other IRC provisions enacted after December 31, 2013, that are not referenced in Wisconsin's tax statutes.

2. For state tax purposes, the Wisconsin statutes currently adopt IRC provisions enacted through December 31, 2010. The bill would adopt IRC provisions enacted in 2011, 2012, and 2013, with exceptions. Over those three years, 16 public laws containing IRC provisions were enacted, and the bill would adopt most of those changes. The bill would not adopt one section of P.L. 112-95, the FAA Modernization and Reform Act of 2012, and eight sections of P.L. 112-240, the American Taxpayer Relief Act of 2012. As noted above, the bill would also include references to three of the five public laws enacted in 2014 containing IRC provisions, but would not include references to P.L. 113-92, the Philippines Charitable Giving Assistance Act, and P.L. 113-295, the Tax Increase Prevention Act of 2014. While the former is expected to have limited significance to Wisconsin taxpayers, the latter contains numerous provisions affecting Wisconsin taxpayers. However, a number of those provisions are scheduled to sunset after the 2014 tax year, including one-year extensions for 50% bonus depreciation and Section 179 expenses.

3. Under a 2013 Act 20 change, the state tax treatment of depreciation refers to IRC provisions in effect on January 1, 2014. Therefore, even though P.L. 113-295 extended bonus depreciation for an additional year, bonus depreciation was not available for state tax purposes in tax year 2014. However, federal and state tax treatment will be the same for most property in tax year 2015, unless Congress extends bonus depreciation again. Under a separate Act 20 change, state taxpayers are generally subject to current Section 179 IRC provisions. For federal and Wisconsin tax purposes in tax year 2014, Wisconsin taxpayers could elect to deduct up to \$500,000 of the cost of qualifying property, rather than taking depreciation over a specified recovery period. Also, the deduction is phased out if a claimant's total eligible investments exceed \$2 million in a single tax

year. Beginning in tax year 2015, the deduction limit for federal and Wisconsin tax purposes will fall from \$500,000 to \$25,000 and the total investment limit will fall from \$2 million to \$200,000. However, any future federal law changes to the Section 179 deduction will automatically be adopted under state law.

4. P.L. 113-97 pertains to a definition, rules, and funding standards for a cooperative and small employer charity pension plan. Some private pension plans are maintained by more than one employer where the employers are either cooperatives or charities. These plans had been exempt from the funding requirements imposed under the Pension Protection Act of 2006 (PPA) until 2017. P.L. 113-97 allows these plans: (a) to be permanently exempt from the PPA funding requirements so long as the plans abide by rules like those in effect before the PPA; (b) to be exempt from the PPA until 2017, at which time the PPA funding requirements would apply; or (c) to phase in their compliance with the PPA funding requirements beginning in 2014. The proposed reference to P.L. 113-97 would keep Wisconsin's treatment of these pension plans the same as the federal treatment.

5. P.L. 113-159 pertains to minimum funding requirements for single-employer defined benefit pension plans. Federal law requires pension plans to meet certain funding standards by maintaining minimum contribution levels. These funding targets are calculated using three different interest rates, called segment rates, depending on when benefits will be payable. The interest rates are based on the interest rates on corporate bonds, averaged over a 24-month period. Recent decreases in these rates have caused the value of benefits to increase, thereby causing increases in required minimum contributions. A 2012 federal law permits a series of five adjustments to the interest rates, based on interest rates averaged over the preceding 25 years. The first adjustment applied to the plan year beginning in 2012 and the final adjustment applied to plan years beginning in 2016 or later. P.L. 113-159 lengthens the period for applying each of the five adjustments, so that the first adjustment will apply to plan years beginning in 2012 through 2017 and the final adjustment will apply to plan years beginning in 2021 or later. The proposed reference to P.L. 113-159 would keep Wisconsin's treatment of these pension plans the same as the federal treatment.

6. P.L. 113-168 clarifies the treatment of general welfare benefits provided by Indian tribes. Tribal welfare benefits include any payment made or service provided to a member of an Indian tribe pursuant to an Indian tribal government program, provided the program is administered under specific guidelines and does not discriminate in favor of members of the tribe's governing body. Further, the benefits provided must: (a) be available to any tribal member meeting the program guidelines; (b) be for the promotion of general welfare; (c) not be lavish or extravagant; and (d) not be compensation for services. These provisions do not extend to gaming payments to tribal members, and those payments are gross income, subject to information reporting and withholding requirements. Gaming payments are not excludable from gross income under the general welfare exclusion. Under the bill, these provisions would extend to tax years beginning after December 31, 2013, and would also apply to tax years 2009 through 2013.

7. Two other public laws that include IRC provisions were enacted in December, 2014, but are not included in the proposal, presumably due to the timetable for developing the budget. Since their enactment, DOR has reviewed both public laws and recommends that the budget bill be amended to include cross-references to certain provisions in these public laws.

8. P.L. 113-295, the Tax Increase Prevention Act of 2014, contains seven provisions that DOR recommends including in the IRC update. Two of the provisions correct technical errors and eliminate obsolete provisions in the Code. Two other provisions relate to the treatment of multiemployer pension plans that are either experiencing funding shortfalls or are underfunded. Arguably, Wisconsin has already accepted these treatments since current law specifies that "a qualified retirement fund for a taxable year for federal income tax purposes is a qualified retirement fund for the taxable year for purposes of ... (the Wisconsin income tax)." Including the appropriate cross references would make the Wisconsin treatment certain.

9. A fifth provision relates to the definition of qualified tuition programs, also known as section 529 plans, such as Wisconsin's Edvest program. Prior to P.L. 113-295, plan contributors and beneficiaries were prohibited from directly, or indirectly, directing the investment of amounts in accounts. Otherwise, the program would lose its status as "qualified," which conveys certain tax advantages. The act modified that provision by allowing contributors and beneficiaries to directly, or indirectly, direct the investment of amounts in accounts no more than two times in any calendar year. A sixth provision excludes dividends received by a U.S. shareholder from a controlled foreign corporation from the definition of personal holding company income. DOR indicates that both provisions would have a minimal fiscal effect.

10. The final P.L. 113-295 provision relates to a new type of tax-preferred account and is the only item with a measurable fiscal effect. Achieving a Better Life (ABLE) accounts allow individuals to make contributions to accounts for disability expenses of designated beneficiaries. Neither account earnings nor distributions from accounts are subject to tax, provided the distributions do not exceed the qualified disability expenses of the designated beneficiary. DOR estimates a minimal revenue loss in 2015-16. As the accounts increase in use and accumulate earnings, the estimated revenue reduction would increase to \$50,000 in 2016-17 and \$130,000 in 2017-18.

11. P.L. 113-287 consolidated a number of existing provisions related to the National Park Service into a unique grouping under Title 16 (Conservation) of the United States Code. The Service is responsible for administering the Historic Sites, Buildings, and Antiquities Act, the National Historic Preservation Act, and other laws relating to protecting and preserving sites that illustrate America's history. Some of the P.L. 113-287 provisions involve grants to various entities, including individuals and small businesses, that allow them to remain located in historic districts. These provisions have tax implications because the grants are treated as taxable income for federal and state income tax purposes. Including cross-references to these provisions in the state income tax statutes would clarify that there has been no change in tax treatment, and there would be no fiscal effect.

## **ALTERNATIVES**

1. Approve the Governor's recommendation to update statutory references to the Internal Revenue Code.

2. Modify the Governor's recommendation by including IRC references to the following

provisions enacted in December, 2014:

- a. Two P.L. 113-295 provisions that correct technical errors and eliminate obsolete provisions in the IRC;
- b. Two P.L. 113-295 provisions relating to the treatment of multiemployer pension plans that are either experiencing funding shortfalls or are underfunded;
- c. The P.L.113-295 provision relating to the definition of qualified tuition programs and limiting contributors and designated beneficiaries from directing investments to no more than two times per calendar year;
- d. The P.L. 113-295 provision that excludes dividends received by a U.S. shareholder from a controlled foreign corporation from the definition of personal holding company income for the purposes of the related rules;
- e. The P.L. 113-295 provision that allows individuals to create Achieving a Better Life (ABLE) accounts on a tax-preferred basis; and

<b>ALT 2e</b> <b>Change to Bill</b>
GPR-REV (Tax) - \$50,000

- f. The 113-287 provisions regarding the taxability of certain National Park Service grants to individuals and small businesses.
3. Delete provision.

Prepared by: Rick Olin