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Revenue Matters - November 13, 2007

Wisconsin Budget Project – WCCF
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Please feel free to forward messages to any other interested parties, and encourage others to sign up for this and/or other WCCF mailing lists at
<http://capwiz.com/wccf/mlm/signup/>

NOTE: There is a meeting of the Wisconsin Way initiative in Janesville this evening (Nov. 13), and WCCF has prepared a comprehensive series of papers about local government finance to accompany the effort. See item #6 for more information.

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1. SUMMARIES OF THE FINAL STATE BUDGET

On October 26, the Governor signed the long-overdue state budget bill for the 2007-09 biennium. WCCF has prepared a 3-page summary of the key budget issues for children and families, as well as an updated version of our comprehensive matrix summarizing the bill as it evolved over the course of each stage of the budget process. The matrix includes a section on the various items that were proposed by the Governor and others to fill the hole in the budget, and also sections about tax cuts and property tax relief. You can find both documents at:

http://www.wccf.org/2007-09_statebudgetessentials.php

Of course, the Legislative Fiscal Bureau (LFB) has prepared a much more comprehensive summary of the final budget bill. You can find that document at:

http://www.legis.state.wi.us/lfb/Misc/2007_10_23_School%20Aids.pdf

Additional summaries of key fiscal policy issues in the budget bill are provided in the next several items in this newsletter.

If you look at either of our summaries on the WCCF website, you'll see that in general the Senate Democrats prevailed on most of the spending items, and the Assembly GOP majority prevailed in defeating most of the proposed tax increases. If that seems incongruous, it is - but it reflects a significant increase in the structural deficit, relative to the earlier versions of the 2007-09 budget.

The LFB calculates something they refer to as the "structural imbalance," which is the amount of general purposed revenue (GPR) growth needed in the next biennium simply to bring the budget into balance, without assuming any spending increases for things like inflation or caseload growth. A recent LFB memo says the structural imbalance is \$892 million, which is roughly \$225 million deeper in the red than the budget initially proposed by the Governor.

However, there's at least a little positive news about the state's progress in getting on a sounder fiscal footing. First, the \$892 million structural imbalance is the lowest in many years. Second, the new budget has a projected ending balance of \$65 million, and that's on top of a surplus \$50 million remaining at the end of FY 2007 that the Governor deposited in the state's Rainy Day Fund, giving the state a total reserve of more than \$105 million. Although that's far from adequate, it's a significant improvement.

An Oct. 23 article in the State Journal discusses the structural deficit:
<http://www.madison.com/wsj/topstories/index.php?ntid=252535&ntpid=1>

2. REVENUE UPPERS IN THE BUDGET BILL

Taxes and fees would go up by \$763 million over the biennium under the recently signed budget. However, that's less than half of what was proposed in Gov. Doyle's original budget, according to a Legislative Fiscal Bureau memo.

<http://www.wispolitics.com/1006/071023LFBTaxFee.pdf>

The new or increased sources of revenue include the following:

- A \$1 per pack increase in the cigarette tax, which generates \$378.5 million in this biennium, plus another \$32 million from increased taxes on other tobacco products.
- Increases in annual vehicle registration fees (including \$20 more per year for passenger vehicles), generating \$144 million during the biennium.
- A 30% increase in registration fees for heavy trucks, generating about \$57 million in 2007-09.
- Nearly doubling vehicle title fees, generating \$52.6 million during the biennium.
- An increase in vital records fees.
- Enhanced collection measures that are projected to increase GPR collections by \$20.8 million for the biennium.

In addition to those revenue uppers, the budget contains a number of one-time revenue sources. A couple of examples include:

- A transfer of \$200 million from the patients compensation fund (which has already generated a lawsuit by the State Medical Society).
- \$40 million from selling state property.

A measure that preserves rather than increases revenue is a Senate amendment closing a sales tax loophole created by the *River City Refuse* decision. That decision threatened sales tax revenue by allowing businesses to evade Wisconsin sales taxes by making certain purchases through out-of-state subsidiaries. Closing the loophole averts a potential revenue loss of \$140 million in 2007-09.

The following proposals for increasing revenue were rejected:

- The proposed hospital gross receipts tax
- An oil supplier gross receipts tax
- The proposed increase in real estate transfer fees
- The Senate proposal to implement combined reporting for corporate income, which would have increased corporate income taxes by \$40.5 million in FY'08 and \$90 million in FY'09.
- A proposal by the Governor in the compromise he offered for the Special Session, which would have closed loopholes for tax shelters and real estate investment trusts, and would have generated \$22 million over the next two years.
- The streamlined sales and use tax provision ("Mainstreet Equity Act").
- Extension of the sales tax to digital personal property.

3. TAX CUTS IN THE BUDGET BILL

The number of new or increased tax cuts is too long to list, but these are some of the more substantial changes:

- The phase-in of an income tax deduction for health insurance premiums -- making every dollar families pay in health premiums completely tax free -- which cuts taxes by \$11.8 million in this biennium and by \$149 million per year in 2011-12 and thereafter.
- A phased-in income tax deduction for some of the costs of child care or dependent care, which wouldn't begin until tax year 2009, and will cut taxes by about \$16 million in FY 2013, once it's fully phased in.
- The Senate version of an income tax exclusion for retirement income, which provides up to \$5,000 per person for taxpayers 65 or older with adjusted gross income of \$15,000 or less. This cuts taxes by \$2.5 million in this biennium and \$11.2 million in the next biennium, but that's just a tiny fraction of the fiscal effect of the much larger exclusion proposed in the Assembly budget.
- Expansion of angel investment tax credits, costing the state \$7.8 million.
- A tax credit for electronic medical records, which will begin in FY 2010 and would cost \$10 million in FY 2011 and thereafter.
- A new sales tax exemption for catalogs, which cut taxes \$600,000 in FY 2009 and \$4.8 million in the next biennium.

-- Updating references to the Internal Revenue Code, which cuts tax revenue by \$13.6 million in 2007-09.

Not all of the tax cut proposals were approved. Some of the ones that didn't make it into the final budget include:

- Assembly provisions to federalize treatment of Health Savings Accounts;
- An expansion of the tax deduction for amounts paid into college savings programs.
- The Assembly proposal for a wellness tax credit for businesses expenditures for workplace wellness programs.
- A proposed sales tax exemption for biotechnology companies.

The new tax cuts reduce general fund revenue by \$38.4 million in 2007-09, but that's just a small fraction of the long-term cost when the cuts are fully phased in.

4. PROPERTY TAX ISSUES IN THE BUDGET

The following are some of the significant measures in the budget relating to property taxes:

-- The bill passed by the Legislature extends the current caps on municipal and county levy increases at 2 percent or the value of new construction (whichever is greater), unless a higher limit is approved by referendum. However, a partial veto changes that for this year only by allowing local governments to increase their 2007 levies by either the percentage increase due to net new construction or 3.86%.

-- Funding for shared revenue for municipalities and counties is frozen (except for a small increase in the utility aid component), which results in the continued decline in the inflation-adjusted value of this state aid.

-- The increase in general school aids had to be decreased to about \$77 million (0.8%), because the DPI had already officially notified districts that general aid in 2007-08 would be the same as in the 2006-07 school year. However, the funding that had to be cut will be delivered to districts via an increase in the School Levy Credit.

-- Funding for special education is increased by \$53.6 million (8.1%).

-- The school levy tax credit is increased by \$79 million for the 2008 property tax year and by \$75 million for the 2009 property tax year.

-- The proposal to adjust the Homestead Tax Credit for inflation was rejected, and the Assembly proposal to end eligibility for about one third of credit recipients was rejected. Funding for the credit is cut by \$13.1 million because the program continues to be eroded by inflation.

5. SENATE APPROVES CORRECTION IN SCHOOL AID DISTRIBUTION

The State Senate voted 25 to 7 last Thursday for a bill proposed by Sen. John Lehman (D-Racine) that would change the way tax relief for schools is distributed. The bill, which

now goes to the Assembly, would prevent the loss of more than \$12 million in property tax savings for residents of 299 school districts across the state.

The problem arose when the Legislature passed the budget bill too late to meet the deadline for changing the level of general school aids that had been allocated among districts for the previous year. That meant school districts could not receive an increase of \$79.3 million in general aid approved by the Legislature and Governor.

To compensate for that loss, the final version of the budget bill shifted the \$79.3 million into the funding for the school levy credit. The intent of the shift was to use the equalization aid formula to distribute that portion of the additional money for the levy credit, thereby achieving the same distribution of aid that had been intended before the budget delay. However, the statutory language in the bill does not achieve that result; instead it applies the school levy credit's distribution formula to the full appropriation, which allocates more of the funding to high-income districts.

Senate Lehman's bill simply accomplishes what the Legislature had intended when it initially crafted the school aid provisions in the budget, and when the Conference Committee finally agreed on its budget compromise. However, it is unclear whether Assembly leaders plan to take up the bill.

http://www.journaltimes.com/articles/2007/11/09/local_news/doc4733f231a26ab868297050.txt

6. "WISCONSIN WAY" PROJECT BEGINS PUBLIC MEETINGS; WCCF PREPARES BACKGROUND MATERIAL

Our current system of financing K-12 education, child welfare programs and other local services in Wisconsin faces serious and growing problems. Coming up with an effective and politically viable alternative will require innovative thinking and a broad-based public dialogue about different and more sustainable ways of financing local government. Fortunately, a diverse set of partners has come together to launch just such an effort, called The Wisconsin Way.

The core group that launched this effort includes the Wisconsin Counties Association, the Wisconsin Education Association Council, Wisconsin Realtors Association, Wisconsin Transportation Builders Association and Wood Communications Group. Many other groups have endorsed the effort.

The Wisconsin Way initiative is hosting a series of public meetings across the state to engage Wisconsin residents in a conversation about how to make taxes fairer and reduce the property tax burden without sacrificing the quality of public services that make Wisconsin a special place to live and work. Eight of these meetings have been held over the last month, starting with one in La Crosse that drew a crowd of nearly 300 people. The upcoming meetings are Nov. 13 in Janesville, Nov. 27 in Milwaukee, Dec. 4 in Kenosha, and Dec. 6 in Madison. Please try to participate.

For more information about the Wisconsin Way, including dates, times and locations of the public meetings, go to: <http://www.wisconsinway.org/>

To assist with this important public dialog, the Wisconsin Budget Process has prepared a series of short papers about local government finance and state property tax relief programs. You can find our comprehensive set of papers at: http://www.wccf.org/budget_localgovfinancing.php

The WEAC website has an article and photo gallery about the La Crosse Meeting: <http://www.weac.org/News/2007-08/oct07/wwforum.htm#>

7. HOUSE BILL RELIEVES ALTERNATIVE MINIMUM TAX, WHILE MAINTAINING FISCAL DISCIPLINE

On Friday the House passed an \$82.5 billion tax bill that balances revenue losses with a contentious plan to raise tax revenue. The tax cutting portions would shield millions of Americans from exposure to the alternative minimum tax, extend expiring tax breaks for a year (such as such as the research and development credit and the deduction for state sales taxes), and expand the child tax credit.

It was approved by a vote of 216-193, with all of the House Republicans and 8 Democrats voting against the plan. The major source of controversy is that it includes something called the carried interest provision, which closes a tax loophole that currently allows equity managers to pay just a 15% tax on their bonuses - a lower rate than all but the lowest income Americans.

The extended tax breaks and AMT "patch" are popular with both parties, but the revenue-raising offsets in the bill have drawn intense GOP opposition and concerns among some centrist Democrats. Most Democrats believe the offsets are necessary to meet the pay-as-you-go budget rules adopted by the Democratic Congress early this year.

The future of the bill is uncertain because of resistance in the Senate to the carried interest provision. Many Republicans and a few Democrats contend that the bill should be exempted from the pay-as-you-go budget rules, thereby allowing it to be passed without all the offsets. In addition, the White House issued a veto threat last week, echoing the argument that offsets aren't necessary.

A Nov. 2 editorial in the Journal Sentinel makes the case for fixing the AMT and not driving up the federal deficit in the process. <http://www.jsonline.com/story/index.aspx?id=681891> An editorial in yesterday's State Journal follows in the next section.

An analysis of the AMT bill by the Center on Budget and Policy Priorities can be found at:

<http://www.cbpp.org/11-7-07tax2.htm>

8. REVENUE ISSUES IN THE NEWS

-- "Rein in bad tax policy" - Nov. 12, State Journal editorial - "Failure is not an option. Congress should keep that warning in mind as it attempts to adopt legislation to prevent the ever-expanding alternative minimum tax from hitting an additional 21 million taxpayers with higher tax bills next April. Wisconsin's congressional delegation should help lead the way through the roadblocks. As many as 500,000 Wisconsin taxpayers would likely face the alternative minimum tax, or AMT, if the law remains unchanged."

<http://www.madison.com/wsj/home/opinion/index.php?ntid=256464&ntpid=1>

-- "Wisconsin Internet access tax grandfathered into federal bill" - Nov. 7, Wis. Technology Network - "A bill that extends the federal moratorium on Internet taxes will not impede Wisconsin's ability to tax access to the Internet because the bill, which is expected to be signed into law by President Bush, grandfathers Internet access taxes previously enacted in Wisconsin and several other states.

The U.S. House of Representatives recently accepted changes made to the bill by the Senate that would ban all state and local Internet taxes for another seven years. However, since Wisconsin's Internet access tax was enacted on Aug. 8, 1991, the state will be allowed to continue collecting its tax. Over the course of the 2007-09 biennium, that would amount to an estimated \$103 million statewide."

<http://www.freep.com/apps/pbcs.dll/article?AID=/20071107/NEWS06/711070392/1008>

-- "Cigarette tax may be only a short-term budget fix" - This Nov. 2 article questions whether the \$1.00 per pack increase in the cigarette tax will generate the projected revenue increase (\$235 million in FY'09, on top of a smaller increase for the remainder of FY'08). That's a very valid question, and the article does a good job of laying out the reasons for concern. However, it should be noted that although the cigarette tax boost amounts to a 130% increase in the tax rate, the projected revenue increase is just 79%. On the other hand, even assuming the projections are accurate for the current biennium, the cigarette tax revenue is likely to be flat or to tail off in future years, and in either of those scenarios the reliance on cigarette and tobacco tax revenue will help exacerbate the state's structural deficit.

<http://www.jsonline.com/story/index.aspx?id=682070>

-- "Legislature must fix Medicaid reimbursement inequities" - This op-ed column in the Nov. 11 Journal Sentinel urges legislators to approve an assessment on hospitals, in order to leverage federal matching funds to increase the state's low Medicaid reimbursement rate for hospitals.

<http://www.jsonline.com/story/index.aspx?id=684462>

-- "State budget process is . . . well, a monster" - This op-ed piece by Ed Huck in the Nov. 2 Journal Sentinel defends the Governor's partial veto of the 2007 revenue caps for municipalities and counties. It concludes by saying, "If we had fewer Frankenstein

budgets, we'd need a lot fewer Frankenstein vetoes."

<http://www.jsonline.com/story/index.aspx?id=681866>

-- "Services tax takes a step toward repeal" - Nov. 7, Detroit Free Press - "A Michigan Senate committee votes to repeal the new sales tax on services, setting up a vote in the full Senate and stoking the campaign to kill the unpopular tax. But how-or whether-to replace the \$614 million the tax would generate this fiscal year remains a vexing question."

<http://www.freep.com/apps/pbcs.dll/article?AID=/20071107/NEWS06/711070392/1008>

-- "Competing Tax Plans" - Nov. 10, Baltimore Sun - "The Maryland Senate and House of Delegates charted divergent courses yesterday for closing a \$1.7 billion budget gap, with the Senate approving a plan that increases the sales, tobacco and corporate income tax rates while House leaders pushed an alternative that more heavily taxes the wealthy and corporations."

<http://www.baltimoresun.com/news/local/bal-te.md.taxes10nov10,0,1789100.story>

9. READING ROOM

-- "A Tale of Two Bills: The Labor-HHS-Education and Defense Appropriations Bills" - This Nov. 12 paper by the Center on Budget and Policy Priorities (CBPP) says the President's claim that he would veto the Labor-HHS-Education bill because of its "irresponsible" and "excessive" funding level does not add up -in light of his other actions.

<http://www.cbpp.org/11-12-07bud.htm>

-- "End the Break On Capital Gains" - In this Washington Post commentary, senior fellow Len Burman explains why the capital gains tax break does more harm than good and why Congress should close the loophole once and for all.

<http://www.urban.org/publications/901101.html>

-- "Families Helped by the Child Tax Credit Expansion Work Hard in Low-Paying Jobs" - This recent CBPP analysis examines the rationale for the provision in the AMT bill to expand eligibility for the child tax credit.

<http://www.cbpp.org/11-7-07tax3.htm>

-- "Tax Gap: A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance" - General Accounting Office, July 13.

<http://www.gao.gov/cgi-bin/getrpt?GAO-07-1014>

Highlights - <http://www.gao.gov/highlights/d071014high.pdf>

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You can donate online at: <http://www.wccf.org/support.php>
