

Wisconsin Council on Children and Families
555 W. Washington Ave., Suite 200
Madison, WI 53703
Phone (608) 284-0580

Revenue Matters – 2008 Issue #2

Wisconsin Budget Project – WCCF
Jon Peacock (jpeacock@wccf.org)
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1. FISCAL BUREAU ESTIMATES \$652 MILLION DEFICIT, ... AND GROWING

New revenue estimates released Wednesday by the Legislative Fiscal Bureau (LFB) project that the state will have a deficit at the end of the current biennium (June 30, 2009) of \$652 million, and several pending court cases could add significantly to that amount. The shortfall results primarily from the effect of the economic downturn on state tax collections, which are projected to fall by \$586.5 million. In addition, the LFB projects a \$35 million decrease in departmental revenues and another \$33.6 million net cost from re-estimates of spending and lapses.

The Department of Administration (DOA) took a couple of actions Tuesday to reduce spending in this biennium by about \$236 million, but that still leaves a deficit of \$416 million. Those actions include directing agencies to find an additional \$111 in savings in their budgets and reducing debt service costs by about \$125 million by rolling over some short term debt (into longer-term debt).

The LFB paper cited three court cases that could cause even greater problems for the state budget:

-- Injured Patients and Families Compensation Fund transfer - The transfer of \$200 million from the fund authorized in the biennial budget has been challenged in court by

the WI Medical Society.

-- Tribal Gaming Revenues - The budget is counting on payments from the Ho-Chunk tribe, including a payment originally due in 2004-05, but the timing and amount of payments could be affected by the outcome of pending litigation.

-- "Menasha" Decision - An Appeals Court ruling last year, which is currently under review in the State Supreme Court, might require the state to pay back sales taxes that corporations have been paying on their purchases of customized computer software. The Supreme Court is expected to rule this spring in the case initiated by Menasha Corporation, and that decision could cost the state \$293 million in the current biennium if the higher court agrees with the Court of Appeals ruling!

You can find the LFB memo at:

<http://www.thewheelerreport.com/releases/Feb08/feb13/0213lfbrevenue.pdf>

An article about the deficit in Thursday's State Journal can be found at:

<http://www.madison.com/toolbox/index.php?action=printme2&ref=wsj&storyURL=%2Fwsj%2Fhome%2Flocal%2Findex.php%3Fntid%3D272346>

2. REACTIONS AND PROPOSALS RELATING TO THE INCREASED DEFICIT

Following the release of the LFB revenue and deficit projections, many GOP leaders in the Assembly and Senate quickly said that the state would have to figure out how to live with the reduced funding. As Assembly Speaker Mike Huebsch stated, a tax increase "is not an option." A few prominent Democrats said more revenue would have to be found, and while no one has hinted at raising tax rates, they are talking about closing tax loopholes. An article Thursday in the WI State Journal quoted the Joint Finance Committee chair, Senator Mark Miller of Monona:

"It would be irresponsible to believe that spending cuts and one-time money alone will put the state back on a track toward financial stability ...In addition, we must close corporate (tax) loopholes."

Some groups have suggested that the state should restore the estate tax, which expired on January 1 of this year because of changes in federal law and inaction on the part of state lawmakers to permanently decouple the state's estate tax from the federal law. In an open letter to the Governor, the Alliance of Cities addressed that issue and called for restoring the estate tax. The estate tax is estimated to generate \$140 million in the current fiscal year, from deaths prior to January 1, but that revenue will drop to just \$30 million in the second year, and will be eliminated in the next biennium (though it would come back in 2011 if neither the state or federal law is amended).

<http://www.thewheelerreport.com/releases/Feb08/feb13/0213allianceofcities1.pdf>

In an article in the Journal Sentinel Friday, the Governor is quoted as saying: "The estate tax (suspension) may be one that you just have to delay a year."

<http://www.jsonline.com/story/index.aspx?id=718512>

The Journal Sentinel article and others have also reported that a hospital assessment is an idea that is back on the table. However, different players have different opinions about how such an assessment should be used. Eric Borgerding of the Hospitals Association says they support the idea, but that support seems to be contingent on using most of the increased revenue to raise MA reimbursement rates for hospitals (which leverages federal matching dollars). The Governor wants to use a big chunk of the assessment to offset GPR spending for Medicaid, and the Senate Majority Leader, Russ Decker, wants to use \$200 million to replace the money transferred from the Patients Compensation Fund.

All of those ideas are defensible, but the money in question can't do all three things - unless each of the parties pares back their expectations significantly. Finding a compromise that can ultimately pass will be a significant challenge, especially since Assembly Republicans, who have been very cool to what they call a "sick tax", will ultimately also have to provide some of the votes for passage.

3. SENATE DEMOCRATS OFFER THEIR OWN ECONOMIC GROWTH PLAN

In January of this year, the Governor proposed a number of targeted tax cuts and other measures that he believes will stimulate long-term economic growth. I summarized his proposals in the last issue. Assembly Republicans have proposed their own package, which overlaps a little bit with the Governor's and also relies on tax cuts. Senate Democrats, on the other hand, offered a growth plan at a late January press conference that goes in a different direction. A January 30 article in the Capital Times summarized the differences between their plan and the Governor's:

"Doyle's plan ...emphasizes long-term private investments in Wisconsin through preferential tax treatment, while the Senate plan calls for immediate direct investments in large-scale public works projects."

<http://www.madison.com/tct/news/270115>

Major elements of the Senate Dems' plan include the following:

- Providing \$5 million a year in increased funding for incentive grants for state technical colleges for "emerging occupations" based on local business needs.
- Increasing funding for renewable energy grants and loans by \$8 million a year.
- Boosting child care assistance by \$15 million annually in order to expand income limits to 210% of poverty for initial eligibility and 225% of poverty for continuing eligibility.
- Increasing funding for state highway building and rehabilitation, which Democrats said would "translate to about 2,500 good-paying jobs for our state."
- Increasing car rental fees by \$13 in Milwaukee, Kenosha and Racine to pay for a regional commuter rail line.
- Increasing financial aid for UW and technical college students by \$1.3 million per year.

In contrast to either the Governor's plan or the one proposed by Republicans, the Senate Dems provide a funding source for their plan - the adoption of combined reporting, which

brings in about \$90 million in additional corporate income tax revenue by making it harder for multi-state corporations to avoid taxes on their earnings by using subsidiaries and creative accounting to ensure that all of the profits accrue in places where they aren't taxed.

To see a description of the Senate Democrats' economic development program, go to:
<http://thewheelerreport.com/releases/Jan08/jan30/0130senecon.pdf>

The new deficit figures will make it very difficult to pass any new tax cuts or spending, especially since the two houses of the legislature and the Governor all have very different ideas about what an effective package should contain.

4. CORPORATE TAX EXPERT CALLS FOR REFORMS

The following is an excerpt from the January 30 Journal Sentinel. In addition, if you haven't already seen it, please take a look at the article by Dennis Collier of our staff in the last issue of the WisKids Journal - "Corporate tax Avoidance: Getting Big Biz to Pony Up Its Fair Share"

<http://www.wccf.org/wkj/208/story2.html>

"Wisconsin's corporate income tax system is antiquated and needs to be reformed, Michael Mazerov told a state Senate committee Wednesday. "Aggressive tax avoidance by large, sophisticated multistate companies is a serious and growing problem," said Mazerov, who is a senior fellow at the Center on Budget and Policy Priorities, a liberal think tank in Washington. "Unfortunately, Wisconsin remains something of a laggard among the states in addressing it."

"Mazerov spoke to the Committee on Tax Fairness and Family Prosperity, which is considering a number of bills to change the way Wisconsin collects the corporate income tax. His remarks were not directed at any particular proposal, but rather were for the general information of members, said Dan Kanninen, chief of staff to committee Chairman Sen. Robert Jauch (D-Poplar).

"However, in his remarks at the Capitol and later during a meeting with Journal Sentinel editors and reporters in Milwaukee, Mazerov said that instituting combined reporting would be the single best action to reform the state's corporate tax system. Under combined reporting, all companies with common ownership file a single tax return. Wisconsin is a separate reporting state, meaning that every company can file its own return, whether or not it has corporate siblings.

"This allows companies in Wisconsin to pay subsidiaries of their parents for such things as the use of logos or rent for property, he said. If the companies receiving the payments are not in Wisconsin, then the state cannot tax them, while the state company is able to lower its profits by the amount it pays. Separate reporting also allows state companies

such as banks to move income earning assets such as securities to subsidiaries in other states and thus avoid taxation by Wisconsin, he said.

"There is a trend toward combined reporting, Mazerov said. Of the 45 states with corporate income taxes, 16 have combined reporting and five more are in the process of adopting it, he said in Milwaukee. Among those with combined reporting are Minnesota and California, both of which have done well economically in recent years, he said."

<http://www.jsonline.com/story/index.aspx?id=713147>

5. REPUBLICANS IN CONGRESS BLOCK A MORE TARGETED STIMULUS BILL

The President signed an economic stimulus bill this week, after a couple of weeks of debate over rather different priorities about what should be in such a bill. The President and most Congressional Republicans wanted increased tax breaks for investments made by businesses, as well as tax rebates for people who have a net tax liability. Most Democrats, particularly in the Senate, espoused a more targeted use of the dollars. They were seeking tax breaks that helped more low-income families - who economists generally think will spend more of their rebates or other assistance, rather than simply saving the money. The Democrats were also seeking to put funding into other forms of helping low-income families, and they argued strenuously for an increase in the length of unemployment insurance benefits for the long-term unemployed.

Ultimately, Senate Democrats only succeeded in making eligibility for tax rebates a bit broader than in the House-passed bill. That was accomplished by extending eligibility for rebates to people who have income from Social Security or veterans' disability benefits but little or no earnings. The House bill would have made the rebates available only for taxpayers with earnings of at least \$3,000, while the final bill signed into law includes the Senate Finance Committee's provision making the rebates available for taxpayers whose combined earnings, Social Security benefits and veterans' disability or survivor benefits equal at least \$3,000.

By a one-vote margin, Republicans in the Senate were able to maintain a filibuster that prevented the Democratic majority from taking up the amendment to extend unemployment insurance benefits from 13 weeks to 26 weeks. Many Democrats had also hoped to amend the bill to increase funding for low income energy assistance and to provide short-term fiscal relief to the states by increasing the federal share of Medicaid spending, but efforts to take up those amendments were thwarted.

According to a summary by Citizens for Tax Justice (CTJ), the final bill "provides a rebate equal to income tax liability up to a maximum of \$600 (\$1,200 for married couples) and provides a minimum rebate of \$300 (\$600 for married couples). The bill also provides an additional \$300 per dependent child. Eligibility begins to phase out for taxpayers with incomes of \$75,000 (\$150,000 for married couples)."

The new law also contains the two business tax breaks in the original House version. Quoting again from CTJ's summary: "The first is so-called bonus depreciation (allowing businesses to immediately write off 50 percent of equipment and other capital) and the second doubles the amount of certain investments that small businesses can immediately expense from \$125,000 to \$250,000. Since investment usually requires some time for planning and implementation, these are unlikely to provide the sort of immediate boost that is needed to forestall or counteract a recession."

CTJ notes that the business tax cuts make up less than a third of the total costs of the bill, with the rebate provisions making up the rest. However, OMB watch recently pointed to a Wall St. Journal article that contends the long-term cost of the business tax breaks was significantly underestimated. <http://www.ombwatch.org/article/blogs/entry/4580/45>

6. UPCOMING PUBLIC HEARINGS

At least two legislative committees are having public hearings Wednesday, Feb. 20, on tax related bills or bill drafts:

Senate Tax Fairness and Family Prosperity, 10 a.m., Wed, Feb 20, 201-SE.

Hearing on:

-- SB-446. (Jauch) Adopts substantive provisions of streamlined sales and use tax agreement.

<http://www.legis.state.wi.us/2007/data/SB-446.pdf>

-- SR-9. (Jauch) Urges Congress and President to enact the Sales Tax Fairness and Simplification Act.

<http://www.legis.state.wi.us/2007/data/SR-9.pdf>

Assembly Committee on Jobs and the Economy, 12:45 p.m., Wed. Feb. 20, 415-NW

-- LRB 4044/1 - Relating to: the early stage seed and angel investment tax credits, the submission of budget information by the department of commerce, and allocating funding to the technology commercialization grant and loan program.

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