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Revenue Matters – 2008 Issue #4

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: This issue focuses primarily on the budget repair bill, which was enacted on May 16 - when the Governor signed it into law but also made 7 vetoes. Item # 1 summarizes the item vetoes and provides a link to an updated comparative summary of the bill on the WCCF website.

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1. GOVERNOR SIGNS & PARTIALLY VETOES BUDGET REPAIR BILL

After a 2-month long special session, the Legislature finally wrapped up work last week on a budget repair bill. It was narrowly approved by the Senate last Tuesday and by the Assembly Wednesday. On Friday it was signed by the Governor, but he made 7 vetoes. The budget deficit webpage on the WCCF website contains an updated summary of the new law - Act 226 - comparing it with the earlier versions of the bill. You can find our summary at:

http://www.wccf.org/budget_resources_deficit2007-09.php

The following are some of the Governor's more significant vetoes:

-- Increased the cuts that are needed to \$270 million (see item #2) and removed restrictions on where cuts can be made.

- Eliminated the provision that would have delayed a \$125 million school aids payment by a couple of weeks, pushing it into the next biennium.
- Maintained the statutory reserve at \$65 million, rather than cutting it by \$40 million.
- Restored \$20 million of the \$22 million that the Governor proposed cutting from the funds for implementation of the federal Real ID act.
- Eliminated the expansion of the property tax exemption for low-income housing. (See item # 5.)
- Preserved the option of cutting child care subsidy spending by reinstating a more restrictive reimbursement policy for providers when children are absent (item #6).

You can find the Governor's veto message at:

<http://www.thewheelerreport.com/releases/May08/may16/0516govvetodetails.pdf>

A Fiscal Bureau explanation of the vetoes can be found at:

<http://www.legis.state.wi.us/lfb/2007-09budget/March%202008%20SS%20AB%201/Act%20226%20Veto%20summary.pdf>

The politics of passing the budget repair were very interesting. In the Senate all the Republicans opposed the bill, and it was approved on a 17-16 vote (w. Senator Carpenter also voting no). In the Assembly, where GOP leaders had a significant hand in crafting the deal, a majority of the Republicans and about 20 Democrats voted for it. The Assembly votes did not fall into any discernible pattern across the political spectrum, which I think reflects that legislators were struggling with a number of tough questions, such as whether it was a responsible budget and whether there was a better alternative that could possibly pass. You can find the Assembly roll call at:

<http://www.legis.state.wi.us/insession/insessiondocs/Votes/av0296.htm>

2. EXECUTIVE BRANCH MUST NOW CUT \$270 MILLION

Prior to the Governor's vetoes, the Conference Committee's version of the budget directed the executive branch to find \$69 million to cut and lapse to the General Fund - on top of the \$200 million required in the biennial budget bill. The vetoes creatively string together numbers to increase the amount that must be lapsed to \$270 million (in addition to the previous \$200 million and another \$10 million GPR that must be cut from the Medicaid budget).

The Legislature's bill would have tied the Governor's hands to some extent - by limiting where he could cut. It provided that none of the new lapses could come from the Dept. of Transportation (DOT), Dept. of Revenue, general or categorical school aids, SeniorCare benefits or tobacco control grants. However, the Governor's vetoes remove those restrictions, and Doyle Administrative officials have said that about \$103 million of the lapses will come out of DOT programs. (The DOT cuts are offset to some extent by \$50 million in new bonding and \$77 million in additional federal funding.)

One of the very unfortunate things about the budget process is that there was virtually no public discussion about where the unspecified cuts would or might come from. The practice of leaving the cutting to the executive branch (with little public attention or involvement) took root over the last decade or so, because almost every budget bill directed agencies to find savings within their operating budgets. However, operating budgets (which are largely composed of staffing and administrative costs) have been squeezed for so long that they are no longer a place where one can expect to find a lot more to cut. As a result, the latest cutting is going to have to come out of the meat of state programs - yet the Legislature has abdicated to the Governor the responsibility of deciding where those cuts should be made. The vetoes that have greatly increased the size of the cuts exacerbate the problem that there will be lots of painful cutbacks, with little or no public involvement or legislative accountability.

The new practice of simply leaving it to the executive branch to find funds to lapse has precluded having an informed public discourse about the pros and cons of budget alternatives. As a result, the last two months of budget deliberations did little to educate the public about alternative budget-balancing options and to prepare for even more difficult budget deliberations that lie ahead.

It remains to be seen whether we will get a full public accounting of where the total of \$470 million in cuts and lapses comes from

A Journal Sentinel article about the cuts can be found at:

<http://www.jsonline.com/story/index.aspx?id=751861>

Yesterday the Fiscal Bureau issued a 17-page memo that lists the hundreds of appropriations that could potentially be lapsed:

http://www.legis.state.wi.us/lfb/2007-09budget/March%202008%20SS%20AB%201/2008_05_21_WI%20Leg%20Lapse%20Provisions.pdf

3. BILL TAKES SMALL, BUT WELCOME STEPS IN CLOSING CORPORATE TAX LOOPHOLES

The Senate's version of the budget repair bill would have significantly restricted the tax avoidance strategies that are increasingly used by large multi-state corporations. It would have accomplished that by adopting combined reporting, which looks at a corporation and its subsidiaries as a single entity for tax purposes, thereby preventing many of the ploys used to avoid taxes by shifting profits to subsidiaries located in other states. That Senate plan would have also reduced corporate tax rates slightly, but was expected to generate a net increase of \$125 million in this biennium.

The final version of the bill doesn't contain combined reporting, but does take a couple of small steps toward reducing corporate income tax loopholes - generating an estimated \$15 million in the current biennium. One change, which had been recommended by the

Governor, yields \$6 million by eliminating a loophole that has allowed Wal-Mart to minimize taxes by transferring its real property to a real estate investment trust (REIT) and then lowering its taxable income by deducting the expense of rent paid to the REIT.

The second chunk of the \$15 million is achieved by closing the loophole that allowed corporate income tax deductions for interest paid to related business entities.

The Institute for Wisconsin's Future issued a brief statement in support of closing the loopholes:

<http://www.thewheelerreport.com/releases/May08/may16/0516institutefutureveto.pdf>

4. STRUCTURAL DEFICIT REACHES \$1.7 BILLION - PRIOR TO THE GOVERNOR'S VETOES

The Conference Committee's version of the budget included just one new revenue source - the \$15 million from eliminating a couple of corporate tax loopholes, as noted above. Most of the budget balancing in that version of the budget was accomplished by various means of pushing the hard choices off into the future, such as generating \$209 million in this budget from the sale of more of the state's future tobacco settlement payments. In conjunction with the Act 20 authority, this would give the state an added \$709 million over the next decade, but would produce a \$1.5 billion loss from FY 2018 through FY 2030 ! The Conference Committee bill would have also delayed a \$125 million school aids payment by a couple of weeks so it falls into the next biennium.

The budget gimmicks so often used by Wisconsin legislators and governors have created a massive budget problem that the state will eventually have to face up to. To shed some light on that challenge, the Legislative Fiscal Bureau (LFB) periodically estimates something they refer to as the "structural imbalance", which is the amount of revenue growth needed in the following biennium simply to maintain current spending levels and to offset phased-in tax cuts, without any inflationary increases for health care, school aids or anything else. (The "structural imbalance" measured by the LFB isn't exactly the same thing as a structural deficit - but it can be determined more easily and more objectively, and it's a good proxy for the structural deficit.)

According to the LFB, the structural imbalance had been coming down a little bit over the last couple of budgets, but after enactment of the biennial budget bill it was still a fairly daunting \$896 million for the 2009-11 biennium. Of course, that was based on previous revenue estimates. After the lower revenue estimates came out in January, and after the budget repair bill addressed the deficit primarily by using short-term gimmicks, the LFB calculated that the Conference Committee plan would increase the structural imbalance to \$1.7 billion (yes, Billion). The most fiscally responsible plan - with respect to the hole left to fill in the next biennium - was the Senate's budget repair bill, which would have left a structural imbalance of \$1.37 billion (because it included the hospital assessment and the adoption of combined reporting to limit corporate tax avoidance). The size of the structural imbalance that would have been created by each of the various

budget repair plans is shown at the bottom of Table 1 in WCCF's comparative summary at: http://www.wccf.org/pdf/budget_repairbill_direct_051308.pdf

Several of the Governor's vetoes will reduce the structural deficit -- including eliminating the delay in the school aids payment and reducing the use of tobacco settlement refinancing. (Of course, the flip side is that they substantially increase the cuts that have to be made in the current budget.) The LFB has yet to recalculate the structural imbalance to reflect the Governor's vetoes.

5. GOVERNOR VETOES PROVISION EXPANDING LOW-INCOME PROPERTY TAX EXEMPTION

The Conference Committee added a handful of measures to the budget repair bill that hadn't been approved by either house of the Legislature. Among those is a provision that would have expanded a property tax exemption for low-income housing owned by nonprofit organizations. The proposed change grew out of the ongoing debate about the appropriate response to the State Supreme Court's 2003 ruling in the *Columbus Park* case, which narrowed the previous tax exemption.

The provision, which the Governor vetoed, would have specified that property owned by churches, religious or benevolent associations and used as low-income housing would be exempt from property tax. It would also have expanded the current exemption by: covering existing low-income housing financed by the Wisconsin Housing and Economic Development Authority and owned by nonprofit organizations, and by altering the current limit on how the owner of low-income rental property uses rent income.

The Governor vetoed the changes, saying that the issue need a more thorough public airing. An editorial in the May 13 WI State Journal ("Stop lawmakers sneaky tax shift") supported a veto:

<http://www.madison.com/wsj/home/opinion/286216>

For conflicting opinions about the expanded tax break, see the response of the Green Bay Mayor Jim Schmitt in favor of a veto, and Senator Russ Decker in favor of the budget provision:

-- Mayor Schmitt:

<http://www.thewheelerreport.com/releases/May08/may16/0516schmittveto.pdf>

-- Senator Decker's statement:

<http://www.thewheelerreport.com/releases/May08/may16/0516deckerveto.pdf>

6. BUDGET REPAIR BILL CLOSES SHORTFALL IN CHILD CARE SUBSIDY PROGRAM

Participation in the Wisconsin Shares child care subsidy program has continued to grow faster than expected, creating a significant shortfall in the program's budget. The Department of Workforce Development (DWD) responded to that shortfall by implementing a change that restricts reimbursement of child care providers when children are absent. That change has been very controversial because it is difficult to monitor administratively, and more importantly because providers have to meet staff child ratios based on the full number of children that might be in the classroom; they cannot simply cut back on the staffing when a child is absent.

The budget repair bill added \$18.6 million to address the Wisconsin Shares shortfall in the first year of the biennium, and the Governor approved that increase. He also directed DWD to pull back a rule implementing the more restrictive absence policy, but he vetoed a provision included in the Conference Committee bill that would have statutorily prevented implementation of that more restrictive reimbursement policy. By vetoing the statutory change, the Governor preserved the agency's ability to apply the policy in the future if cost-saving measures are needed again in FY 2009 or beyond.

The Capital Times posted an editorial on the subject today, quoting WCCF's acting director, Jill Jacklitz, who notes that ultimately legislators are going to have to find new revenue sources to be able to maintain critical supports for kids and working families: <http://www.madison.com/tct/opinion/287578>

A letter from a number of legislators expressing concern about the absence policy can be found at: <http://www.thewheelerreport.com/releases/May08/may16/0516grigsbyveto.pdf>

WCCF issued a press release early last week applauding the Conference Committee for making it a priority to remedy the shortfall (http://www.wccf.org/pdf/budgetrepair_wccfstmt_051208pr.pdf) and another last Friday thanking the Governor for approving the funding increase.

7. REVENUE ISSUES IN THE NEWS

-- "And the belt tightens" - This May 20 editorial explains how the Governor's vetoes accomplished the feat of rewriting the amount that must be cut, and concludes that: "The governor wisely opted for increased spending cuts. This won't be painless, but it is a sign that the state grasps the fiscal realities. However, spare the UW Growth Agenda." <http://www.jsonline.com/story/index.aspx?id=752443>

-- "Wisconsin's 124 nonprofit hospitals would have paid \$117 million in property taxes" - May 15, WI State Journal - "Wisconsin's nonprofit hospitals were exempt from paying more than \$117 million in property taxes in 2006, says a new report from the Institute for Wisconsin's Future. The lack of that money makes it harder for local governments to provide vital services, the report says. Nonprofit hospitals provide charity care, but so do

for-profit hospitals that pay taxes, the report says." (See also item #8, below.)

<http://www.madison.com/wsj/home/local/286626>

-- "Falling bridges" - May 5, Governing.com - "As aging infrastructure becomes harder to ignore, state and local leaders search for new ways to finance solutions."

<http://www.governing.com/articles/0805hark.htm>

-- "Group calls for county wheel tax" - May 5, Journal Sentinel - "A \$10-a-car countywide vehicle registration fee could be one of the best options for keeping the financially troubled Milwaukee County Transit System intact, the Public Policy Forum says in a report to be released Monday."

<http://www.jsonline.com/story/index.aspx?id=746727>

-- "In the 'holiday' spirit" -- This editorial from the May 2 Journal Sentinel takes a critical look at the proposal for a summer gas tax holiday.

<http://www.jsonline.com/story/index.aspx?id=746103>

-- "States Get In on Calls for a Gas Tax Holiday" - May 6, NY Times

www.nytimes.com/2008/05/06/us/06gas.html

-- "Experts say raise alcohol tax and limit supply to curb Wisconsin's thirst" - May 08, New Richmond News - "Health and policy experts say Wisconsin could reduce over-consumption of alcohol by raising the liquor tax and making it less available."

<http://www.newrichmond->

[news.com/articles/index.cfm?id=16473&ion=Wisconsin%20News&property_id=18](http://www.newrichmond-news.com/articles/index.cfm?id=16473&ion=Wisconsin%20News&property_id=18)

-- "State funding drives many school referendums" -- This April 4 article in the Oshkosh Northwestern does a nice job of reporting on the relationship between the "dysfunctional" state system of funding public K-12 education and the growing reliance on ballot measures to provide additional school financing.

<http://www.thenorthwestern.com/apps/pbcs.dll/article?AID=/20080405/OSH0101/804060582/1128/OSHnews>

8. READING ROOM

-- "Hospitable Taxes: How non-profit hospitals profit from our out-dated tax system" - A recent report by the Institute for Wisconsin's Future concludes that non-profit hospitals in WI own at least six billion dollars worth of tax-exempt property that could be generating at least \$117 million in property taxes yearly to help support local services. The 124 tax-exempt hospitals and medical centers are located in 100 communities statewide. Because they generally do not pay property taxes, homeowners and business owners are forced to pay the hospitals' share of the cost of local services. The report includes data on each non-profit hospital in the state, including potential local property tax payments.

<http://www.wisconsinsfuture.org/>

-- "Hidden Consequences: Lessons from Massachusetts for States Considering a Property Tax Cap" - This May 21 paper by the Center on Budget and Policy Priorities examines Massachusetts' experience under its property tax cap, known as Proposition 2 1/2, and offers the following lessons for other states that are considering similar measures:

- * A tax cap won't make government services cost less.
- * Claims that caps will produce large savings through "efficiencies" are overblown.
- * Tax caps can be particularly harmful if adopted during a weak economy.
- * State aid can't be relied upon to fill the gap.
- * Changes in school enrollment can have a big impact.
- * Without effectively targeted state aid, low-income communities will fall even further behind.
- * Wealthier communities will override a tax cap more frequently than poorer ones.
- * Middle-income communities might end up bearing the brunt of a cap.

<http://www.cbpp.org/5-21-08sfp.pdf>

-- "Funding prisons at the expense of schools" - The Economic Policy Institute (EPI) took a look at state spending on prisons and universities and found a disturbing trend: Since 1987, spending for incarceration has greatly outpaced spending for higher education. Several states (CT, VT, MI & OR) actually spend more on incarceration than they do on higher education. An EPI Snapshot shows the difference on a national and state-by-state level.

http://www.epi.org/content.cfm/webfeatures_snapshots_20080312

-- "GAO Study Again Confirms Health Savings Accounts Primarily Benefit High-Income Individuals" - This paper by the Center on Budget and Policy Priorities summarizes a new Government Accountability Office (GAO) report -- which examines IRS data for tax year 2005, as well as employer surveys, and found:

- * Health Savings Accounts (HSAs) are used disproportionately by affluent households.
- * Affluent HSA participants contribute much more to the accounts than other participants.
- * Many HSA participants appear to be using their accounts purely or primarily as a tax shelter rather than paying for out-of-pocket health care costs.
- * Many employers offering high-deductible health insurance plans and HSAs did not contribute to their workers' HSAs.

<http://www.cbpp.org/5-19-08health.pdf>

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