WISCONSIN BUDGET PROJECT

An Initiative of the Wisconsin Council on Children and Families

New Year Brings At Least $210 Million in New Tax Cuts
Phased-in Cuts Contribute to Structural Deficit

At least eight new or expanded state tax cuts and tax credits will go into effect at the beginning of 2011. These tax changes add up to an estimated $210 million cut in state taxes over the 2011-13 biennium. After adding in other tax reductions with different effective dates, we calculate that tax changes contribute more than $320 million to the structural deficit for the coming biennial budget.

Tax increases often garner more attention than tax cuts. The 2009-11 biennial budget implemented several well-publicized tax increases, but what's often lost in the discussion is that the budget also included a number of targeted tax cuts described in this brief.

The eight tax cuts described below all have one thing in common: none went into full effect immediately after being enacted. Lawmakers either set a starting date for the tax cut at a future date, or phased in the cut so that the amount of the cut increased over time.

Policymakers sometimes take this delayed or phased-in approach in an attempt to mitigate the fiscal effects of the associated revenue loss. While the fiscal effects may seem small in the first period after the tax change, policymakers must eventually either cut spending or find new revenue sources to make up for the shortfall by the time the cut is fully implemented.

About the Data

Estimates for fiscal effects of tax changes are taken from a July 2010 Legislative Fiscal Bureau memo.

Eight New or Expanded Tax Cuts

We have identified at least eight tax cuts or credits that are either new or expanded in tax years 2010 or 2011. The cost of these changes, represented by revenue lost to the state over the biennium, ranges in size from $78.0 to $2.0 million.

The cuts include:

- <u>Deduction for certain health insurance premiums, $78.0 million over the biennium</u>

  Individual income tax deductions for premiums paid by employees whose employer pays some of the employee's health insurance costs are phased in starting in tax year 2009. The share of deductible expenses increases from 10 percent in tax years 2009 and 2010 to 25 percent in 2011, 45 percent in 2012, and 100 percent in 2013 and thereafter.

  Income tax filers can deduct these expenses from their income regardless of whether they itemize or claim the standard deduction.

  This provision was originally enacted as part of the 2007-09 budget, but the scheduled phase-in was later postponed.

- <u>Deferral of capital gains invested in new business ventures, $50.0 million</u>

  Taxpayers can subtract up to $10 million in capital gains from their income for individual income tax purposes if the money is reinvested in a qualified new business venture. The new business venture must be certified by the Department of Commerce as developing a new product or engaged in particular industries and conducting research and development.

  The new deferral begins with tax year 2011.

- <u>Expansion of angel investment tax credits, at least $26.0 million</u>

  Angel investors are accredited investors who make cash investments in new business ventures in exchange for stock or ownership.

  Beginning with tax year 2011, the aggregate amount of credit available increases from

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$5.5 million per year to $20.0 million. This credit is available through the individual income tax.

- Deduction for certain medical care insurance premiums, $16.0 million

  An individual with no employer and no self-employment income may deduct 100 percent of the cost of medical care insurance premiums for purposes of the individual income tax, beginning in tax year 2011. This change is an increase from a deduction of 66.7 percent in tax year 2010.

  This deduction was originally enacted as part of the 2005-07 budget, but the scheduled phase-in was later postponed.

- Deduction for child care expenses, $16.0 million

  In tax year 2011, individuals can deduct up to $750 ($1,500 for couples) in child and dependent care expenses from their income for individual income tax purposes. This represents the first year of a phased-in deduction that reaches its maximum at $3,000 for an individual in tax year 2014 and thereafter.

  This deduction was originally enacted as part of the 2007-09 budget, but the phase-in was later postponed.

- Expansion of early stage seed credit, at least $12.0 million

  This credit is provided under the individual income and corporate income taxes, and the insurance premiums tax, and gives a credit for investments paid to a fund manager that are then invested in certain businesses.

  The maximum aggregate amount of credit available increased to $20.5 million beginning in tax year 2011, up from $6.0 million in previous years.

- Super research and development credit, $10.0 million

  This is a corporate income tax credit for corporations that incur unusually large research expenses in a particular year. This credit goes into effect beginning with tax year 2011.

- Beginning farmer credit, $2.0 million

  This credit gives a beginning farmer a credit through the individual income and corporate income tax for enrolling in a financial management program. This credit goes into effect for tax year 2011.

More Phased-In Tax Cuts Coming

Several more tax cuts and credits are already scheduled to take place starting later in 2011 or in 2012, totaling an additional estimated $61.0 million over the 2011-13 biennium.

Some of the additional tax cuts include:

- A sales tax exemption for equipment used in biotechnology that begins in January 2012 ($20.0 million),

- A credit towards the individual and corporate income tax for electronic medical records, beginning in tax year 2012 ($15.0 million). This credit was originally scheduled to be implemented earlier but was postponed, and

- A refundable jobs credit for the individual and corporate income tax that rewards increases in the net employment in a business. Credits will be paid in tax years 2012 and after, although they can be claimed earlier ($15.0 million).

Conclusion

The new year brings a collection of new tax cuts, and expansions of pre-existing cuts. Phased-in or delayed tax cuts are generally much easier to enact than cuts that go into full effect immediately, because the revenue impact is not felt until later down the road. But when the full cost is realized, legislators must either reduce spending or find other sources of revenue.

Wisconsin has gotten itself into a deep fiscal hole by ducking tough choices. Politicians often make promises that come with a significant price tag, while avoiding the matter of how to foot the bill. That happens when policymakers defer questions about paying for new tax breaks as well as questions about how to pay for new spending.

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