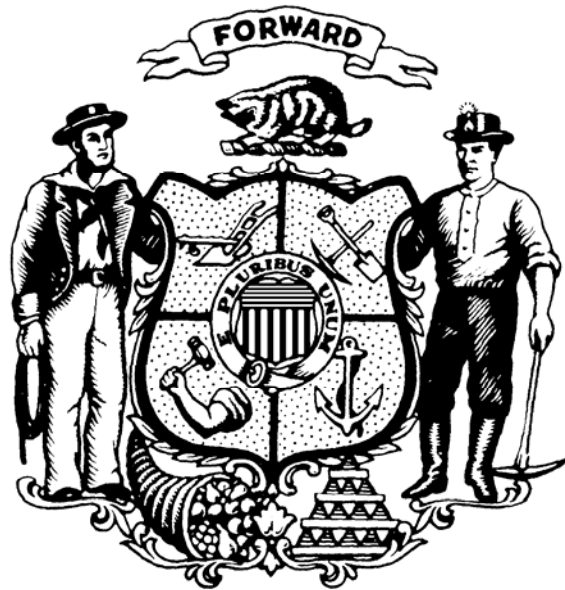


**STATE OF WISCONSIN**

**SUMMARY OF TAX  
EXEMPTION DEVICES**

JIM DOYLE, GOVERNOR



February 2007

**Division of  
Executive Budget and Finance  
DEPARTMENT OF ADMINISTRATION**

**Division of  
Research and Policy  
DEPARTMENT OF REVENUE**



# State of Wisconsin • DEPARTMENT OF REVENUE

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**Jim Doyle**  
Governor

**Roger M. Ervin**  
Secretary of Revenue

January 16, 2007

To members of the 2007-08 Legislature:

Every two years, the Department of Revenue is required—under section 16.425 of the Wisconsin Statutes—to prepare a summary of existing tax exemption devices. This *Summary of Tax Exemption Devices* facilitates a comprehensive review of tax exemption devices and their corresponding fiscal effects. This type of review is important if we are to keep the revenue loss associated with current state tax exemptions in perspective.

The report represents the efforts of staff in the Department of Revenue, Division of Research and Policy, with contribution from the Office of the Commissioner of Insurance. Great care has been taken to provide as accurate and complete a report as possible. The Department of Revenue hopes that members of the Legislature and others find the document to be a useful tool in the formulation of public policy decisions. Research staff in the department stands ready to answer any questions you may have concerning material in this document.

Sincerely,

A handwritten signature in blue ink, appearing to read "Roger M. Ervin".

Roger M. Ervin  
Secretary of Revenue

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## INTRODUCTION

Wisconsin's state and local governments rely on tax revenues to fund valuable services to our citizens. Ensuring that our system of taxation is fair, equitable, and efficient is vital to our economic success and quality of life. In setting tax policies, we must consider taxpayers' ability to pay, the impact of those policies on economic development, and the interaction of tax policies with other policy goals.

Tax exemptions are an important component of Wisconsin tax policies. A tax exemption is "...any tax provision that exempts, in whole or part, certain persons, income, goods, services or property from the impact of established taxes."<sup>1</sup> Granting a tax exemption can be a powerful tool for providing economic development incentives or for mitigating the regressive qualities of certain tax types. However, exemptions always come with a cost. Exemptions reduce revenues otherwise available for programs or for tax relief for taxpayers who do not benefit from the exemption. Therefore, it is critical that policymakers understand both the costs of exemptions and their effectiveness at achieving their intended goal.

Recognizing the need for this information, the legislature mandated that a report be presented biennially to the legislature listing all tax exemption devices and their fiscal effects. The first report was presented in 1975 and this is the 17<sup>th</sup> report compiled by the Department of Revenue.

### Highlights of the Report

The report is organized by tax type. For each, it describes the various exemptions that are currently authorized and provides estimates of the fiscal effects in fiscal year 2006 (FY06) where data is available. Detailed explanations of each tax type are available on the Department of Revenue web site at <http://www.revenue.wi.us/report/index.html>.

On a case by case basis, the estimates provide a valuable benchmark for discussion of whether the policy justifications warrant the loss in revenue or if other tools, such as direct expenditure programs, could be considered as alternatives. As the examples below demonstrate, determining the degree to which exemptions meet their policy objectives is challenging, due to the difficulty of quantifying the outcomes and in some cases needing to make assumptions regarding the underlying goal.

#### *Individual Income Tax Exemptions*

The individual income tax is the largest generator of revenues for state government. In FY06, income tax collections of \$6.1 billion represented 51.1% of state General Purpose Revenue (GPR) tax collections. Exemptions from the income tax include deductions or exclusions from taxable income and tax credits. A tax exclusion refers to a type of income that is not taxable and does not need to be reported on the tax return, such as income from qualifying scholarships. A deduction refers to an amount that is subtracted from total taxable income that is reported, such as a deduction for capital gains and the standard deduction. Credits are a direct reduction in the tax liability that is owed. For non-refundable credits, the credit cannot exceed total tax liability. In contrast, refundable credits can exceed tax liability, resulting in a payment due to the taxpayer.

Many income tax exemptions are based on Wisconsin's consistency with federal tax policy. For example, Wisconsin conforms to the federal exclusion of payments received for sickness or injury benefits, which had an estimated cost of \$1.05 billion for Wisconsin in FY06. While this is clearly a high cost exemption, removing the exemption would reduce the benefit of other policy programs such as worker's compensation, proceeds from insurance policies, and allowance for injuries incurred in military action.

Other income tax exclusions are unique to Wisconsin. For example, Wisconsin allows taxpayers to subtract from income 60% of the capital gains on assets held more than one year. This deduction cost \$277 million in FY06.

An example of a refundable tax credit is the homestead credit that provides a credit to low income renters and homeowners to offset a portion of property taxes. The cost of the program in FY06 was \$122 million.

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<sup>1</sup> From Wisconsin Statutes Section 16.425 (2).

However, its parameters are not indexed for inflation, so the scope of individuals that it benefits decreases as incomes rise.

### *Sales Tax Exemptions*

Wisconsin generated \$4.1 billion in FY06 from its 5% sales and use tax, which represented 34.3% of state GPR taxes. In addition, counties and professional football and baseball stadium districts are authorized to collect additional sales tax from the same tax base. Goods and services that are exempt from this tax therefore lower revenues for both the state and local governments.

One of the largest exemptions from the sales tax is the exemption for food purchased for home consumption, which was estimated to reduce state revenues by \$550 million in FY06. Since food items represent a larger portion of the incomes for low-income individuals, removing this exemption would have implications for health and quality of life programs.

Another significant exemption is for goods sold to other state and local governments and schools, which reduces revenues by an estimated \$295 million. Removing this exemption would result in a situation where one taxing authority imposes a tax on another.

In contrast to tangible goods that are taxed unless specifically exempt in statute, services are exempt unless they are singled out for taxation. Of those services that continue to be exempt, the largest exemptions are in the areas of professional services and business services. These categories include a variety of services such as health professionals which account for \$495 million in foregone revenue, and legal and computer services which reduce revenues by over \$100 million each.

### *Property Tax Exemptions*

The local property tax generates more revenue than either the state sales or income tax. Property taxes collected in 2006 for taxes levied in 2005 totaled \$8.3 billion, which represents the combined levy of school districts, municipalities, counties, technical colleges, and special districts. The state establishes policies regarding what real and personal property is subject to the local property tax, guided by the uniformity clause of the state constitution, which prohibits differential treatment of most property including partial exemptions.

Real property that is exempt from taxation includes property owned by religious establishments, educational and medical facilities, and residential property that is owned by benevolent associations. In total it is estimated that the value of this exempt property is \$22.5 billion. There are also a number of exemptions to personal property taxation, most notably the exemption for machinery and equipment for manufacturing, which comprises an estimated value of \$12.0 billion.

If the exempt property examined in this report were taxable, property tax rates would be reduced by an estimated 8.6% statewide, ranging from a 12.6 % reduction in cities to a 3.2 % reduction in towns.

Clearly these exemptions have implications for economic development, health, housing, and education policies in Wisconsin, and the impact on the property tax should be analyzed in the context of those benefits.

### *Other Exemptions*

The report also discusses exemptions relating to the corporate income tax, insurance premium taxes, recycling surcharge, real estate transfer fees, public utility taxes, and forest crop and managed forest laws.

## **Limitations of the Report**

Readers should be aware of several limitations to the report.

The fiscal impacts of tax exemption devices are often difficult to measure, and estimates of the effect of tax exemptions are subject to limitations and the need to make assumptions. Generally, in calculating each fiscal effect, it is assumed that only the provision in question is changed and that all other aspects of the tax system remain the same.

All of the estimates are based on the impact of the exemption devices in FY06 to allow for the use of actual data. Changes in taxpayer behavior or economic activities since that time are not reflected.

Consistent with accepted revenue estimating practices, the estimates also assume that economic variables, taxpayer behavior and other factors would be unaffected by the repeal of an exemption device. For some devices, these assumptions are open to question. For example, the removal of an income tax deduction could significantly alter spending or investment behavior.

In addition, the estimates are only as good as the data available. In some cases, the estimates are very reliable, however in other cases little data is available or we must rely on external sources. Therefore, the estimates should generally be viewed as indicative only of the order of magnitude of tax exemption costs.

Due to these data limitations and interactions between various exemptions, it is not necessarily accurate to sum across the exemptions to arrive at a total fiscal impact. Each estimate is made in isolation. If two or more items were eliminated, the combined effect may be more or less than the sum of their respective estimates.

In addition to listing tax exemption devices and estimating their impacts, the statutes require that the tax exemption report contain "policy purposes and indicators of effectiveness in achieving such purposes" for each item. As discussed above, it is difficult to determine what policy considerations prompted the enactment of each tax exemption device and to evaluate the degree to which policy goals have been achieved. Because no standard for such evaluation has been established, the department has not been able to comply with this requirement.

# INDIVIDUAL INCOME TAX

## Introduction

The individual income tax is Wisconsin's largest tax source, generating \$6,144 million, or 51% of state general purpose revenue taxes in FY06. Wisconsin first enacted its income tax in 1911 – two years before the federal income tax was imposed.

Wisconsin imposes the income tax on a base that generally conforms to the base for the federal income tax – federal adjusted gross income (FAGI) is the starting point for the Wisconsin tax calculation. FAGI is calculated on the federal return by reporting the various kinds of income – for instance, wages and salaries, interest and dividends, business earnings, retirement income – and then making adjustments for certain kinds of income or expenses. Major adjustments include:

- Contributions to individual retirement accounts and to retirement plans of self-employed persons.
- Deduction for 100% of health insurance premiums paid by the self-employed.
- One-half of the self-employment tax paid for social security and Medicare coverage.
- Up to \$2,500 in interest on student loans when income does not exceed prescribed limits.
- Alimony paid; to the extent the payments are included in the income of the recipient.

In the Wisconsin tax calculation, modifications, both additions and subtractions, are made to FAGI in the determination of Wisconsin adjusted gross income (WAGI). Additions are types of income that are exempt from federal tax but subject to state tax, or deductions allowed for federal but not Wisconsin purposes. The major addition is state and municipal bond interest, which states, but not the federal government, may tax. Another addition results from differences in the amount of capital losses that taxpayers may offset against income – \$3,000 under federal law, but \$500 under Wisconsin law. Taxpayers who deduct more than \$500 in losses for federal purposes must add back the excess in calculating WAGI.

Subtractions are types of income taxable under federal law but exempted by Wisconsin and certain expenses for which Wisconsin allows a deduction. Major subtractions include:

- 60% of capital gains on assets held for more than one year. These gains are fully included in federal taxable income, though long-term gains are taxable at lower rates than ordinary income.
- Interest on U.S. government bonds, which the federal government may, but states may not, tax.
- Pensions received by persons who were members of or retired from Milwaukee City and county retirement funds, the state teachers' retirement fund, and the civil service retirement system prior to January 1, 1964. In addition, veterans' pensions are exempt from Wisconsin income tax.
- A portion of social security benefits that is taxable for federal purposes. Up to 85% of social security benefits are subject to federal tax, but Wisconsin limits the amount taxed to 50% of benefits. For taxable years beginning in 2008 or after, all federally taxable social security benefits are allowed as a subtraction.
- A portion of unemployment compensation, which is fully taxable under federal, but taxed by Wisconsin only when income exceeds \$18,000 for married couples and \$12,000 for most other filers.
- Tuition payments to post-secondary institutions in Wisconsin and to schools in Minnesota covered under Minnesota-Wisconsin tuition reciprocity. For each qualified student, the subtraction is limited to two times the average amount charged to resident undergraduates by the University of Wisconsin System at four-year institutions.
- Premiums paid for long-term care insurance.
- The full amount of health insurance premiums paid by the self-employed and 50% of premiums paid by employed persons whose employer does not contribute to their health insurance. Starting in 2006, the 50% subtraction for employed persons whose employer does not contribute to their health insurance will be

increased to 100%. Additionally, a subtraction for individuals with no self-employment income and no employer will be phased-in during 2007 and 2008. In 2009 the full amount of health insurance premiums paid by these individuals will be allowed as a subtraction.

WAGI is reduced by a standard deduction and personal exemptions to yield Wisconsin taxable income. Wisconsin provides a sliding scale standard deduction, equal to some maximum when income is below a specified level; this maximum deduction is phased down to \$0 as income increases. For instance, in 2005, the deduction for single persons was \$8,170 when WAGI was less than \$11,770, and it declined to \$0 as income increased from \$11,770 to \$79,853. The deduction parameters for each filing status are shown in Table 1; the maximum deduction and phase-out range are indexed annually for inflation. Unlike federal law, Wisconsin does not allow itemized deductions; instead it provides an itemized deductions credit, discussed below, equal to 5% of certain deductions in excess of the standard deduction.

**TABLE 1  
WISCONSIN STANDARD DEDUCTIONS, 2005**

Filing Status	Maximum Deduction	Phase-Out Range	Phase-out Rate
Single	\$8,170	\$11,770 - \$79,853	12%
Head of Household	\$10,550	\$11,770 - \$34,404*	22.515%
Married Filing Jointly	\$14,710	\$16,520 - \$90,895	19.778%
Married Filing Separately	\$6,990	\$7,850 - \$43,192	19.778%

\* Income at which head of household deduction equals the deduction for single filers. Above this income level, the deduction for heads of households is the same as that for single persons.

WAGI is also reduced by a personal exemption equal to \$700 for each tax filer, spouse, and dependent. There is an additional exemption of \$250 for each tax filer and spouse age 65 or older.

Wisconsin taxable income, equal to WAGI less the standard deduction and personal exemptions, is the base to which statutory tax rates are applied to yield gross tax liability. As Table 2 shows, Wisconsin imposed a series of graduated tax rates, ranging from 4.6% to 6.75%. The top rate applies only to filers with substantial amounts of income – in 2005, on income exceeding \$137,410 for single persons and \$183,210 for married couples filing jointly. Bracket ceilings are indexed for inflation.

**TABLE 2  
WISCONSIN TAX RATES AND BRACKETS, 2005**

Tax Rate	Taxable Income Brackets		
	Single	Married - Joint	Married – Separate
4.60%	\$0 - \$9,160	\$0 - \$12,210	\$0 - \$6,110
6.15%	\$9,160 - \$18,320	\$12,210 - \$24,430	\$6,110 - \$12,210
6.50%	\$18,320 - \$137,410	\$24,430 - \$183,210	\$12,210 - \$91,600
6.75%	More than \$137,410	More than \$183,210	More than \$91,600

Finally, gross tax is reduced by credits against the tax liability. Major non-refundable credits, which are limited to the amount of income tax liability otherwise due, include:

- The itemized deductions credit, equal to 5% of the amount by which certain federal itemized deductions exceed the standard deduction. Deductions allowed for the credit are those for medical expenses, mortgage interest on a primary residence located in Wisconsin, investment interest on securities the income from which is subject to Wisconsin tax, and charitable contributions.
- The school property tax credit, equal to 12% of the first \$2,500 of property taxes, or rent constituting property taxes, for a maximum credit of \$300. Rent constituting property taxes equals 20% of rent if heat is included in rent, and 25% if heat is not included.
- The working families credit, which eliminated tax liability below \$18,000 for married couples filing jointly and \$9,000 for other tax filers and which is phased out over the next \$1,000 of income above these amounts.
- The married couple credit for couples when both spouses are working, equal to 3% of the earnings of the lower earning spouses, but not more than \$16,000, resulting in a maximum credit of \$480.



- The credit for military income earned outside the United States, to the extent the income is included in WAGI, equal to the amount of those earnings, but no more than \$300.
- Historic rehabilitation credits, including a supplement to the federal historic rehabilitation credit equal to 5% of qualifying expenditures under the federal Internal Revenue Code and a state historic rehabilitation credit equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings.
- A credit for income taxes paid to other states on wages or other earnings in those states. No credit is allowed for states with which Wisconsin has reciprocity, that is, agreements under which each state agrees not to tax the wages earned within its borders by residents of the other state. Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan, and Minnesota. Because the number of Wisconsin residents working in Illinois and Minnesota is substantially higher than the number of residents of those states working in Wisconsin, Wisconsin annually makes a payment to those states to compensate them for the net revenue loss they incur as a result of reciprocity.

In addition to nonrefundable tax credits, Wisconsin also offers refundable credits, which are paid to claimants in the form of a tax refund when the amount of the credit exceeds tax otherwise due. These credits are essentially subsidies provided to particular types of claimants through the tax system. These credits are:

- The Homestead credit, which equals up to 80% of property taxes or rent constituting property taxes when household income does not exceed \$8,000. Maximum property taxes allowable under the credit are \$1,450, so the maximum credit is \$1,160. The credit is phased out as household income rises from \$8,000 to \$24,500. Rent constituting property taxes equals 20% of rent when heat is included in rent and 25% of rent when heat is not included.
- The earned income tax credit (EITC), calculated as a percentage of the federal earned income tax credit depending on family size: 4% for persons with one child, 14% for persons with two children, and 43% for persons with three or more children. In 2005, the federal credit for persons with one child was equal to 34% of earnings up to \$7,830, for a maximum credit of \$2,662. The credit for single persons was phased out as the greater of FAGI or earnings rose from \$14,370 to \$31,030; the phase-out floor and ceiling was \$2,000 higher for married couples. For persons with two or more children, the federal credit was 40% of earnings up to \$11,000, for a maximum credit of \$4,400. The credit was phased out for single persons as income or earnings rose from \$14,370 to \$35,263; the phase-out floor and ceiling was \$2,000 higher for married couples. Thus, the maximum Wisconsin credits were \$106 for persons with one child, \$616 for persons with two children, and \$1,892 for persons with three or more children.
- The farmland preservation credit for owners of farmland that was zoned exclusively for agriculture use or covered under a farmland preservation agreement with the state. The credit is calculated by determining "excessive property tax" on land and improvements, which is the amount of allowable property taxes less a portion of household income in excess of \$5,000 (ranging from 7% of household income between \$5,000 and \$10,000 to 37% of household income in excess of \$30,000). "Excessive property tax" is limited to \$6,000 and the potential credit is equal to 90% of the first \$2,000 of excessive property taxes, 70% of the next \$2,000 and 50% of the remaining \$2,000, for a maximum potential credit of \$4,200. The amount of credit actually received is 70%, 80%, 95% or 100% of the potential amount, depending on whether the claimant participates in the farmland preservation program through zoning or a contract and depending on the action taken on a farmland preservation plan or zoning by the county or municipality in which the farmland is located. The minimum credit is 10% of excessive property tax.
- The farmland tax relief credit equal to a percentage, determined by the Department of Revenue, of property taxes on farmland exclusive of improvements; the maximum credit is \$1,500. The Department of Revenue annually determines the credit percentage and amount of property taxes that can be claimed so that total expenditures on the credit for all claimants is \$15 million, adjusted for expenditures in excess of, or less than, this amount in the prior fiscal year. The credit for tax year 2005 was based on 20% of the first \$7,500 of property taxes.
- The veterans and surviving spouses property tax credit equal to the amount of property taxes paid on the claimant's principal dwelling. This credit is available to certain disabled veterans who are at least 65 years of age. It is also available to un-remarried surviving spouses of veterans who died while on active duty, during training, or had a service connected disability rating of 100% at the time of death. In all cases the

veteran must have been a Wisconsin resident at the time of entry into service and at either the time of death or the year for which the credit is claimed.

In addition to this regular tax, Wisconsin imposes an alternative minimum tax that may limit the benefit of some tax exemption devices. The alternative minimum tax is equal to 6.5% of alternative minimum taxable income above the applicable exemption amount (\$40,250 if single, \$58,000 if married filing a joint return, and \$29,000 if married filing a separate return for tax year 2005).

### **Estimates of Fiscal Effects**

Estimates of individual income tax exemption devices are provided in Table 3. Descriptions of each device follow the table. The table identifies the exemption devices, indicates the statutory section allowing the exemption device, and provides an estimate of its fiscal effect in FY06.

Several approaches were used to generate the estimates shown in Table 3. The estimates of exclusions from gross income, which are not reported on tax returns, were generally based on estimates of the fiscal effect of federal tax expenditures – i.e., federal tax exemption devices – contained in the annual budget document issued by the Executive Office of the President. Estimates prepared by the Congressional Budget Office and the staff of the Joint Committee on Taxation were also considered. Generally, Wisconsin's share of the federal fiscal effect was determined using the state's share of total federal adjusted gross income on all federal tax returns, and then adjustments were made to account for the differences in federal and Wisconsin tax rates.

Most of the other estimates were based on Wisconsin-specific data sources, including the 2005 Wisconsin individual income tax model, aggregate statistics from the 2005 tax processing year, and tax collection statistics for FY06. The tax model is derived from a scientifically stratified sample of approximately 22,000 tax returns, weighted to reflect the statewide population of tax filers in 2005. This model was used to simulate the effect of tax exemption devices for which data is captured in the sample. The aggregate statistics were drawn from tax returns processed from July 1, 2005 to June 30, 2006.

**TABLE 3  
INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference*	FY06 Fiscal Effect
<b>Exclusions from Federal Gross Income</b>		
Gain from Sale or Exchange of Residence (Home)	IRC 121	\$132,000,000
Social Security Benefits	IRC 86	192,000,000
Railroad Retirement Annuities and Pensions	IRC 86	2,340,000
Public Assistance	IRC 61	3,010,000
Sickness and Injury Benefits	IRC 104 to 106	1,050,000,000
Group Term Life Insurance Purchased for Employees	IRC 79	15,100,000
Death Benefits	IRC 101	58,800,000
Meals and Lodging to Employees	IRC 119	9,180,000
Scholarships and Fellowships	IRC 117	10,500,000
Awards and Prizes	IRC 74 (b) and (c)	Minimal
Payments to Victims of Nazi Persecution	IRC 61 (P.L. 107-16, Section 803)	Minimal
Rental Value of Parsonages	IRC 107	3,500,000
Reduced Armed Forces Retirement Pay	IRC 122	Not available
Combat Pay and Other Armed Forces Exclusions	IRC 112 and 134	50,400,000
Life Insurance Dividends	IRC 7702	32,200,000
Cancellation of Business Property Indebtedness	IRC 108 (a)	Minimal
Income Realized from Debt Cancellation Through Bankruptcy	IRC 108	Not available
Interest on Certain State and Local Bonds	ss. 66.1201 (14)a, 66.1333 (5)(a)4.c and 71.05 (1)(c)	Not available
Gifts and Inheritances	IRC 102	Not available
Appreciation of Property Held at the Time of Death	IRC 1014	84,900,000
Employer Contributions to Pension Plans and Net Pension Fund Earnings	IRC 401 to 404A, 406 to 407 and 409 to 417	646,000,000
Employer Reimbursement of Employee's Educational Expenses	IRC 127	4,290,000
Employer-Provided Child Care	IRC 129	5,590,000
Employer-Provided Adoption Assistance	IRC 137	729,000
Roth Individual Retirement Accounts	IRC 408A	14,000,000
Education Individual Retirement Accounts	IRC530	625,000
Transportation and Other Fringe Benefits	IRC 132 (a)	23,800,000
Foster Care Payments	IRC 131	1,620,000
Cancellation of Student Loans	IRC 108 (f)	Minimal
Recovery of Tax Benefit Items	IRC 111	Minimal
Foreign Earned Income	IRC 911	20,600,000
Natural Resource-Related Cost-Sharing Payments	IRC 126	Minimal
Passive Activity Losses	IRC 469	8,360,000
<b>Adjustments to Federal Gross Income</b>		
Capital Losses	IRC 1211; s 71.05 (10)(c)	5,800,000
Losses from the Sale or Exchange of Business Property	IRC 62 (a)(3)	4,140,000
Pension, Profit-Sharing, Annuity and Bond Purchase Plans of Self-Employed Individuals	IRC 62 (a)(6)	15,400,000
Individual Retirement Accounts (IRAs)	IRC 62 (a)(7), 219, 408, 408A, and 530	15,000,000
Student Loan Interest	IRC 221	6,620,000
Self-Employment Tax	IRC 164 (f)	17,700,000
Health Insurance of Self-Employed Persons	IRC 162 (l)	21,900,000
Educator Expenses		1,070,000
Medical Savings Accounts	IRC 220, 223	Not available
Moving Expenses	IRC 217	1,220,000
Alimony	IRC 62 (a)(10), 71 and 215	9,200,000
Penalty on Early Withdrawal of Savings	IRC 62 (a)(9)	369,000

**TABLE 3  
INDIVIDUAL INCOME TAX EXEMPTION DEVICES SUMMARY (continued)**

Exemption Devices	Statutory Reference*	FY06 Fiscal Effect
<b>Wisconsin Modifications to Federal Adjusted Gross Income</b>		
Social Security Benefits: Difference in State and Federal Treatment	s. 71.05 (6)(b)21	51,900,000
Interest on U.S. Obligations	s. 71.05 (6)(b)1	13,000,000
Capital Gains Deduction	s. 71.05 (6)(b)9	277,000,000
Capital Gains from Qualified Small Business Stock	s. 71.05 (6)(b)6	Not available
Gains on Sales of Business Assets to Related Persons	s. 71.05 (6)(b)25	149,000
Net Long-Term Capital Losses (Pre-1982)	s. 71.05 (14)	Minimal
Public Pensions	s. 71.05 (1)(a), (am) and (an)	54,300,000
State Legislators' Per Diem Expenses	s. 71.05 (1)(b)	79,000
Small Business (Subchapter S) Corporation Subtractions	s. 71.05 (10)(b)	Not available
Distributive Share of Estates and Trusts	s. 71.16 (1)	Not applicable
Distributive Share of Partnership Modifications	s. 71.05 (9)	Not applicable
Wisconsin Net Operating Loss Carryover	s. 71.05 (8)	4,720,000
Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment	s. 71.05 (6)(b)19 and 20	4,230,000
Long-Term Care Insurance Expenses	s. 71.05 (6)(b)26	5,830,000
Constant Basis Assets	s. 71.05 (13)(b)	Minimal
Adjusted Basis of Assets Acquired after January 1, 1965	s. 71.05 (19) and (20)	Minimal
Unemployment Compensation	s. 71.05 (6)(b)8	2,980,000
Disability Income	s. 71.05 (6)(b)4	Minimal
Adoption Expenses	s. 71.05 (6)(b)22	255,000
Higher Education Tuition Expenses	s. 71.05 (6)(b)28	20,200,000
Prepaid Tuition and College Savings Plans	s. 71.05 (6)(b)23 and 31 to 33	6,920,000
Viatical Settlement Contracts	s. 71.05 (1)(f)	Minimal
Payments to Victims of Nazi Persecution	s. 71.05 (6)(b)30	Minimal
Human Organ Donation Expenses	s. 71.05 (10)(i)	Minimal
Active Duty Military Pay	s. 71.05 (6)(b)34	Minimal
<b>Deductions and Exemptions from Wisconsin Adjusted Gross Income</b>		
Sliding Scale Standard Deduction	s. 71.05 (22)	578,000,000
Personal Exemption and Additional Elderly Exemption	s. 71.05 (23)	189,000,000
<b>Wisconsin Credits</b>		
Itemized Deductions Credit	s. 71.07 (5)	321,000,000
School Property Tax Credit	s. 71.07 (9)	383,000,000
Working Families Credit	s. 71.07 (5m)	328,000
Married Couple Credit	s. 71.07 (6)	275,000,000
Armed Forces Member Credit	s. 71.07 (6m)	979,000
Credit for Sales Tax on Fuel and Electricity Used in Manufacturing	s. 71.07 (3s)	16,400,000
Development Zone Credits	s. 71.07 (2dm) and (2dx)	3,900,000
Dairy Investment Credit	s. 71.07(3n)	11,900,000
Angel Investment Credit	s. 71.07(5d)	585,000
Early Stage Seed Investment Credit	s. 71.07(5b)	109,000
Veterans' and Surviving Spouses' Property Tax Credit	s. 71.07(6e)	658,000
Historic Preservation Credits	s. 71.07 (9m) and (9r)	1,630,000
Earned Income Credit	s. 71.07 (9e)	82,000,000
Homestead Credit	ss. 71.07 (4), 71.51 to 71.55	122,000,000
Income Taxes Paid to Other States/Income Tax Reciprocity	ss. 71.07 (7), 71.10 (7) and (7e)	190,000,000
Claim of Right Credit	s. 71.07 (1)	Minimal
Farmland Tax Relief Credit	s. 71.07 (3m)	13,100,000
Farmland Preservation Credit	ss. 71.07 (3) , 71.57 to 71.61	12,300,000
* These are references to sections of the 2005 Wisconsin Statutes, except "IRC" indicates a reference to a section of the federal Internal Revenue Code authorizing the exemption device.		

## EXCLUSIONS FROM FEDERAL GROSS INCOME

An exclusion is a type of income that is not included in federal gross income by provisions of the Internal Revenue Code or under the U.S. Constitution, or in Wisconsin income by provisions of the Wisconsin Statutes. Excluded income does not have to be reported on the income tax return.

### Gain from Sale or Exchange of Residence (Home)

A taxpayer may exclude from income up to \$250,000 (\$500,000 for married couples filing jointly) of capital gain realized on the sale or exchange of a residence. The taxpayer generally must have owned and occupied the home as a principal residence for at least two of the five years prior to the sale. An individual not meeting the ownership or residence requirements is allowed a pro rata amount of the exclusion if the sale or exchange is due to a change in employment, health, or other unforeseen circumstances. The exclusion is allowed on only one sale every two years, and it is not permitted on properties in which depreciation is allowed for rental or business use.

### Social Security Benefits

Old-age and survivors' insurance benefit payments, state old-age assistance payments, and Medicare benefits are generally excluded from the gross income of the person receiving such benefits. Federal law subjects up to 50% of benefits to tax when income exceeds a base amount and up to 85% of benefits when income exceeds an adjusted base amount. In this determination, income equals modified adjusted gross income plus one-half of social security.

The base amounts, for determining tax on up to 50% of benefits, are \$25,000 for single persons, including married persons filing separately who lived apart from their spouses for the full tax year; \$32,000 for married couples filing a joint return; and \$0 for married persons filing separately who lived with their spouses for at least part of the year. The adjusted base amounts, for taxing up to 85% of benefits, are \$34,000 for single persons, \$44,000 for married couples, and \$0 for married persons filing separately and living with their spouses for at least part of the year.

Wisconsin only partially follows the federal treatment, taxing up to 50% of social security benefits. The table provides separate fiscal estimates of the state revenue loss resulting from the federal exclusion and the loss resulting from the state modification to FAGI that limits the amount of social security benefits subject to tax to 50%, rather than 85%, of the total. For taxable years beginning in 2008 or after, Wisconsin will not tax any social security benefits.

### Railroad Retirement Annuities and Pensions

Annuities or pensions paid under the 1935 and 1937 Railroad Retirement Acts are generally excluded from gross income. Up to 50% of Tier 1 retirement benefits are taxable for federal tax purposes, but the Railroad Retirement Acts specifically prohibit state taxation of retirement benefits, so Tier 1 benefits are completely excluded from gross income for state purposes.

### Public Assistance

Assistance provided under the Wisconsin Works program, Medicaid, general relief, and other public assistance to individuals and families is excluded from the gross income of the recipients.

### Sickness and Injury Benefits

Compensation for sickness or personal injury excluded from gross income includes the following:

- Amounts received under the worker's compensation and social security acts,
- Damages received as a result of a court suit or other legal settlement in a personal injury case,
- Proceeds received from an accident, health or medical insurance policy paid for by the taxpayer,
- A pension, annuity or similar allowance for sickness or injury sustained while active in the armed forces, the Coast and Geodetic Survey, the Public Health Service or the Foreign Service, and disability income received by an employee of the United States for injuries incurred in a terrorist attack during the performance of duties outside the U.S.
- Employer contributions to an accident or health plan designed to benefit the employee, and
- Sick pay or employer-financed disability benefits, other than reimbursement for medical expenses deducted

in the same year or a prior year, which is regarded as taxable income.

### **Group Term Life Insurance Purchased for Employees**

The cost of group term life insurance provided to an individual under a policy carried by an employer is generally considered taxable income. However, the cost incurred in purchasing the first \$50,000 worth of coverage is excluded from the gross income of employees.

### **Death Benefits**

Amounts paid under a life insurance contract are excluded whether these sums are paid at one point or over time.

### **Meals and Lodging to Employees**

Employees may exclude from gross income the value of any meals or lodging provided to them for the convenience of the employer. Meals must be furnished on the employer's business premises and lodging must have been accepted by an employee as a condition of employment.

### **Scholarships and Fellowships**

Scholarships and fellowships are excluded from gross income when received by a degree candidate at an educational institution and when used to pay tuition and course-related fees or to purchase books, equipment, and supplies. Amounts used for room and board, however, must be included in income. Scholarships and fellowships do not qualify for the exclusion if they are made either to compensate the recipient for services provided, or to allow the recipient to pursue studies or research that primarily benefit the person or institution paying the scholarship and fellowship.

### **Awards and Prizes**

Awards or prizes received in recognition of religious, charitable, scientific, educational, literary or civic achievement may be excluded from gross income if the amount received is transferred to a government agency or a charitable organization. Further, the exclusion applies only if the recipient was selected without any action on his or her part to enter the competition for the award and only if the recipient is not required to render any substantial future services as a condition of receiving the award.

Employee awards for length of service or achievement are generally excludable from gross income to the extent of the deduction claimed by the employer. Deductions of such awards are limited.

### **Payments to Victims of Nazi Persecution**

Restitution payments received by persons persecuted by Nazi Germany, or countries allied to it, or received by their heirs or estates are excluded from gross income.

### **Rental Value of Parsonages**

The allowance paid to a minister for the purpose of renting a home, or the rental value of the home furnished as part of compensation, is excluded from gross income. In both cases, the associated utility expenses are considered part of the allowance and, as such, excluded from gross income.

### **Reduced Armed Forces Retirement Pay**

The amount deducted from retirement or retainer pay of members or former members of the United States Armed Forces under the Retired Serviceman's Family Protection Plan is excluded from gross income. The reduction in retirement pay is made by contract between the member of the service and the Armed Forces for the purchase of an annuity. This reduction is between 12.5% and 50% of retirement pay, but in no case less than \$25. If the person should die before the amount of the contract is paid, the survivor receiving the annuity may exclude from gross income any reductions in annuity payments used to conclude the contract.

### **Combat Pay and Other Armed Forces Exclusions**

The monthly compensation of members of the United States Armed Forces is excluded from gross income if the taxpayer served in a combat zone. The exclusion for commissioned officers is limited to the maximum amount that enlisted personnel may exclude. Currently designated combat zones and hazardous duty areas include:

- Afghanistan, along with Uzbekistan, Kyrgyzstan, Pakistan, Tajikistan, and Jordan;
- the Federal Republic of Yugoslavia (Serbia/Montenegro), Albania, the Adriatic Sea, and the Ionian Sea north of the 39th parallel;
- Bosnia, Herzegovina, Croatia, and Macedonia;
- the Persian Gulf, the Red Sea, the Gulf of Oman, the part of the Arabian Sea that is north of 10 degrees north latitude and west of 68 degrees east longitude, the Gulf of Aden, and the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, and the United Arab Emirates;
- The Philippines (only troops with orders referencing Operation Enduring Freedom);
- Yemen and Djibouti; and

Exclusions applicable to miscellaneous Armed Forces income are:

- All payments of benefits under any law administered by the Veterans' Administration (38 U.S. Code 3101);
- A pension of \$100 per month for all persons over the age 65 who are on the Army, Navy, Air Force, or Coast Guard Medal of Honor roll (38 U.S. Code 562);
- Benefits under World War Adjusted Compensation Act;
- Benefits under World War Veteran's Act;
- Leave compensation payment under Armed Forces Leave Act;
- G.I. Bill educational benefits;
- In-kind benefits provided to armed forces personnel;

### **Life Insurance Dividends**

Dividends on matured insurance policies may be excluded from gross income for income tax purposes.

### **Cancellation of Business Property Indebtedness**

A taxpayer need not recognize income when a debt of the taxpayer is fully or partially canceled if the individual incurred the debt in connection with property used in a trade or business. The taxpayer must agree to reduce the basis (cost) of the property if an economic benefit was realized as a result of the discharge of a debt for the purpose of determining future depreciation and capital gains or losses.

### **Income Realized from Debt Cancellation through Bankruptcy**

When a debt is forgiven in connection with a bankruptcy proceeding, the income realized is not subject to tax unless the principal purpose of the bankruptcy plan is the evasion of income taxes.

### **Interest on Certain State and Local Bonds**

In general, interest on obligations of state and local governments is subject to the Wisconsin income tax, even though such income may be exempt from federal taxation. However, interest on the following bonds is exempt:

- bonds issued by city housing authorities, city redevelopment authorities, local exposition districts and local cultural arts districts;

- bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) before January 29, 1987 (except business development, economic development, and housing revenue bonds);
- Wisconsin professional baseball park and football stadium district bonds;
- Wisconsin Housing Finance Authority (WHFA) bonds (that is, bonds issued before 1983, when WHFA became known as WHEDA);
- bonds issued by the Government of Puerto Rico, Guam, the Virgin Islands or for bonds issued after October 16, 2004, the Government of American Samoa; and
- Wisconsin higher education bonds.

### **Gifts and Inheritances**

The value of property received by gift, inheritance, devise or bequest is excluded from gross income. This exclusion does not apply to the income from property received by gift or bequest nor to a gift or bequest consisting of income from property rather than the property, itself.

No records are available on the total value of property transferred by gift or inheritance, so a comprehensive estimate of the revenue loss has not been calculated. Property transferred at death, for deaths occurring after September 30, 2002, is subject to the Wisconsin estate tax when the value of the estate exceeds \$675,000. Only about 2% of all estates are subject to this tax; however, they account for a substantially larger share of the total value of property transferred at death, since they are the very largest estates. The estate tax is, in a sense, a substitute for income tax due if inheritances were included as income for these largest estates. Wisconsin estate taxes paid by these estates during FY06 were \$109 million.

Under 2001 Act 16, for deaths occurring on or after January 1, 2008, the Wisconsin estate tax will be based on federal law in effect at that time. Under current federal law, this implies that the Wisconsin estate tax will no longer be imposed for deaths occurring on or after January 1, 2008. However, the elimination of the federal estate tax is scheduled to sunset at the end of 2010. If the sunset occurs, the Wisconsin estate tax will once again be imposed for deaths occurring after December 31, 2010.

### **Appreciation of Property Held at the Time of Death**

Appreciation (gain) from property held at the time of death is not subject to tax for either the deceased or his or her heirs. The basis of inherited property generally is its fair market value at the time of the decedent's death, rather than its cost when the decedent acquired it. As a result, the appreciation of the property while it was held by the decedent – the difference in fair market value at the time of death and the decedent's cost of purchasing the property – is not taxed.

With the repeal of the federal estate tax in 2010, this exclusion will be eliminated in that year. The basis of the property for the heir will be the decedent's basis of the property, so the appreciation of the property while it was owned by the decedent will be taxable income for the heir when he or she sells the property. Under current federal law, the repeal of the federal estate tax and the change in basis rules for property transferred at death are scheduled to sunset at the end of 2010—the estate tax and the current basis rules will be reinstated, barring further changes in federal law.

The estimate of the revenue loss from this exclusion reflects the effect of Wisconsin's 60% exclusion for long-term capital gains.

### **Employer Contributions to Pension Plans and Net Pension Fund Earnings**

Amounts contributed to qualified pension, profit-sharing, stock bonus, bond purchase, and annuity plans by an employer on behalf of his or her employees are generally not treated as income taxable to the employees at the time the contributions are made. Further, employers may generally deduct these contributions from gross income, and the earnings that accrue on the contributions are excluded from the employee's income, so long as the assets are retained within a qualified plan.

Tax is imposed when distributions are made from the plan to employees in the form of pensions and annuities. At that time the taxable portion of the plan benefits must be included in the gross income of the recipient. The portion of the benefits representing the employee's contribution to the plan is not taxable upon distribution if the employee's contributions were already included in income and subject to tax at the time the contributions were made.

Taxing employer contributions and earnings on pension plan assets at the time of withdrawal, rather than at the



time of contribution, results in a revenue loss if the plan beneficiary pays tax at a lower rate when retired than when working.

### **Employer Reimbursement of Employee's Educational Expenses**

Up to \$5,250 of non-job related employer-provided educational assistance may be excluded from gross income.

### **Employer-Provided Child Care**

The value of child or dependent care services provided by an employer under a nondiscriminatory plan is excluded from gross income to the extent that the amount excluded does not exceed \$5,000 (\$2,500 for married separate filers). Further, the value of services excluded may not exceed the earned income of the employee or the earned income of an employee's lower-earning spouse.

### **Employer-Provided Adoption Assistance**

Up to \$10,630 per child in adoption assistance provided by an employer is excluded from gross income. The \$10,630 exclusion is allowed for special needs adoption even if that amount exceeds actual expenses incurred. The exclusion is phased out for persons with modified adjusted gross income between \$159,450 and \$199,450. The amount excludable and the phase out ranges are indexed for inflation.

### **Transportation and Other Fringe Benefits**

Employer-provided transportation in a commuter vehicle, transit passes, and parking are excluded from income of the employee receiving these benefits. In 2005, the exclusion for commuter transportation or transit passes is limited to \$105 per month and the exclusion for parking is limited to \$200 per month. These amounts are indexed for inflation.

Other fringe benefits excluded from income include services provided by employers to employees at no additional cost to the employer, employee discounts, property or services for which an employee would be allowed a deduction if the employee provided that property or service, property or service of minimal value, reimbursement of moving expenses, and retirement planning services. Only the transportation benefits have a measurable fiscal effect.

### **Foster Care Payments**

Foster care payments to care providers by a state or local government or a foster care placement agency are excluded from income.

### **Cancellation of Student Loans**

The amount of a student loan funded by federal, state or local government programs that has been forgiven is not included in taxable income when the cancellation is contingent upon the beneficiary working for a specified period of time in a certain area or for a particular type of employer.

### **Recovery of Tax Benefit Items**

Income from the recovery of an amount for which a tax deduction or other benefit was claimed during the previous year is not included in income if the deduction did not reduce income tax liability in that previous year. However, if the deduction led to reduced tax liability in a prior year, then the recovery is taxable. An example of a recovered tax benefit item is a debt that is written off in one year but received in a later year.

### **Foreign Earned Income**

Qualified individuals who work abroad and receive earned income from foreign sources may elect to exclude up to \$80,000 of such income in 2005. The exclusion amount is adjusted to take into account employer-provided housing allowances, or housing expenses where allowances are not provided, and the maximum exclusion is reduced for taxpayers who work abroad for only part of a year. Effective for taxable years beginning after December 31, 2005, the income exclusion will increase to \$82,400.

**Natural Resource-Related Cost-Sharing Payments**

Payments received by individuals primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife may be excluded from gross income.

**Passive Activity Losses**

In general, when the deductions exceed the income from a business activity, the resulting loss can be offset against other types of income. However, passive activity losses – those from business activities in whose management or operation taxpayers do not actively or materially participate – are subject to passive loss restrictions. Under the restrictions, passive losses can only be offset against other passive income. Passive losses subject to the restrictions are suspended and carried forward indefinitely until used against other passive income or until the taxpayer disposes of the ownership interest in the passive business activity in a fully taxable transaction.

Certain activities are explicitly treated by the tax code as either passive or active. For example, interest, dividends, annuities, royalties and other portfolio income are not treated as income from a passive activity, so net losses generated from passive activities cannot be used to offset portfolio income.

A rental activity generally is treated as a passive activity, though a limited exception exists for rental activity losses incurred by a taxpayer who actively participates in the rental real estate venture and owns at least a 10% interest in the rental property. Under the exception, up to \$25,000 of losses from rental real estate may be used to offset income from non-passive sources. The \$25,000 maximum is reduced (but not below zero) when the taxpayer's adjusted gross income exceeds \$100,000 and is completely phased out when AGI exceeds \$150,000. Special rules apply for married taxpayers who file separate returns and live apart. A taxpayer with a working interest in oil and gas activities is also exempt from the passive loss rules.

**Viatical Settlement Contracts**

A viatical settlement is a payment to the holder of a life insurance policy, or to the certificate holder of a group life insurance certificate, which insures the life of a person who has a catastrophic or life-threatening illness or condition. The payment is less than the expected death benefit of the policy or certificate to the person making the payment. Income received under such a viatical settlement contract is exempt from the income tax.

**Payments to Victims of Nazi Persecution**

Settlements or other payments of claims for assets stolen, hidden or lost by a person due to persecution by Nazi Germany or any Axis regime from 1933 to 1945 are not included in federal gross income.

**ADJUSTMENTS TO FEDERAL GROSS INCOME**

An adjustment is an amount subtracted from gross income to arrive at adjusted gross income.

**Capital Losses**

Losses from the sale or exchange of capital assets may be used to offset gains from capital assets. If the amount of capital losses exceeds the amount of capital gains in the current year, the net capital loss may be used to offset up to \$500 of ordinary income for Wisconsin tax purposes (under federal law, the offset is limited to \$3,000). The amount of net capital loss not allowed as a deduction in the current year may be carried forward to future years to offset capital gains or ordinary income up to the \$500 limit, up to 15 years.

Wisconsin treatment of long-term losses incurred prior to tax year 1982 also differs from the federal treatment. The Wisconsin modification for these pre-1982 long-term losses is described in the section on "Modifications to Federal Adjusted Gross Income."

**Losses from the Sale or Exchange of Business Property**

Losses from the sale or exchange of property used in a business are deductible.

## **Pension, Profit-Sharing, Annuity, and Bond Purchase Plans of Self-Employed Individuals**

A self-employed taxpayer may deduct from gross income contributions made on the taxpayer's behalf to a pension, profit-sharing, annuity or bond purchase plan. Contributions must be made from earned income.

### **Individual Retirement Accounts (IRAs)**

Taxpayers may receive tax benefits from three different types of individual retirement accounts under federal law: the traditional IRA, the Roth IRA, and the education IRA.

#### **1. Traditional IRA**

Persons contributing to a traditional IRA may claim a deduction for the amount contributed and are not taxed on the earnings that remain in a traditional IRA. IRA contributions and earnings on them are taxable when withdrawals are made from the account.

The deduction for contributions is limited to persons who are not covered by an employer-provided retirement plan or who are covered by such plans but have adjusted gross income, for tax year 2005, less than \$50,000 for single persons, \$70,000 for married persons filing jointly or \$0 for married persons filing separately. These income floors are being increased each tax year through 2007. The deduction is phased out over the next \$10,000 of income.

For tax year 2005, the deduction is generally limited to \$4,000 for each tax filer and spouse, but not more than the person's earnings. For married couples, the combined IRA deduction may not exceed combined earnings; in other words, a spouse with little or no earnings may still claim an IRA deduction if the other spouse has earnings in excess of his or her own IRA deduction. These maximum contributions are coordinated among the three types of IRAs; the combined contribution to all IRAs for any one person cannot exceed \$4,000 or the person's earnings. The maximum contribution will be increased to \$5,000 in 2008. Further, taxpayers age 50 and older are allowed additional "catch-up" contributions of \$500 in 2005 and \$1,000 in subsequent years.

With limited exceptions, amounts in a traditional IRA cannot be withdrawn without penalty prior to age 59½. Early withdrawals must be included in gross income and are also subject to an additional 10% penalty tax. The 10% early withdrawal penalty does not apply in cases of death and disability or when the withdrawals are used for qualified higher education expenses or first-time homeowner expenses (up to \$10,000). Amounts withdrawn from an IRA after age 59½ must be included in gross income in the year of the withdrawal. Withdrawals must begin after the individual reaches the age of 70½. Insufficient withdrawals after age 70½ are subject to a penalty tax.

Persons can make nondeductible contributions to their retirement accounts and the earnings on those nondeductible contributions can be excluded from income, as long as the assets are retained within the retirement account.

#### **2. Roth IRA**

A Roth IRA is an account for which the contributions are not deductible when made, but qualified distributions, including earnings on contributions, are not taxable. Persons whose adjusted gross income does not exceed \$95,000 if single, \$150,000 if married filing jointly or \$0 if married filing separately may contribute up to \$4,000 per person per year to a Roth IRA. The amount of contribution permitted is phased out as income rises to \$110,000 for single filers, \$160,000 for married joint filers, and \$10,000 for married separate filers.

The increases in contribution limits and the catch-up contributions for taxpayers age 50 and older that apply to traditional IRAs also apply to Roth IRAs.

Distributions from a Roth IRA are not subject to tax if they are made no earlier than five years after the account is established and if the taxpayer has reached age 59½. Earlier distributions are not subject to tax if they are made because of the death or disability of the taxpayer or for first-time homebuyer expenses (up to \$10,000). Nonqualified distributions must be included in gross income and are subject to a 10% penalty tax. Unlike a traditional IRA, distributions from a Roth IRA are not required upon reaching the age of 70½.

### 3. Education IRA

An education IRA (also known as a Coverdell Education Savings Account) is similar to a Roth IRA: contributions are not deductible, but qualified distributions are not subject to tax if they are used to pay the post-secondary expenditures of the beneficiary.

For tax year 2005, contributions of up to \$2,000 per child may be made to an education IRA when income is less than \$95,000 for single persons and \$190,000 for married couples filing jointly. The amount that may be deducted is phased out as income rises to \$110,000 for single filers and \$220,000 for married joint filers.

#### Student Loan Interest

Persons who have taken out loans on behalf of themselves, their spouse or their dependents to pay for the cost of attending an eligible educational institution may deduct the interest they pay on these loans. The maximum deduction allowed is \$2,500. For 2005, the maximum deduction amount is reduced for single and head of household filers when FAGI is more than \$50,000 and is eliminated when FAGI exceeds \$65,000; for married joint filers the deduction is phased out between \$105,000 and \$135,000 of FAGI. The \$50,000 and \$100,000 amounts are indexed for inflation. Married separate filers and those filers claimed as dependents on another's return may not claim the deduction.

#### Qualified State Tuition Programs

Distributions from qualified tuition programs, whether these plans are state-sponsored or offered by private institutions, are exempt from federal tax. Under these programs, contributors purchase tuition credits or certificates on behalf of a designated beneficiary, entitling the beneficiary to a waiver of payment of qualified higher education expenses. Prior to 2002, earnings on these contributions were deferred until distributed and then taxable to the beneficiary, rather than the contributor. Wisconsin provides its own exemption for earnings on prepaid tuition and college saving plans, described in the "Modifications to Federal Adjusted Gross Income" section.

#### Self-Employment Tax

Self-employed persons are allowed to deduct one-half of their self-employment taxes, which are paid for social security and Medicare coverage. This deduction equalizes treatment between self-employed and employed persons. For the employed, the social security tax is shared equally by the employer and the employee; the amount paid by the employer is not considered income to the employee and is deductible for the employer.

#### Health Insurance of Self-Employed Persons

Under federal law, self-employed persons can deduct up to 100% of premiums paid for health insurance. The deduction may not exceed the earned income from the trade or business for which the insurance plan was established. Wisconsin has its own deduction for up to 100% of the premiums paid for health insurance by self-employed persons, which was put in place when only a partial deduction was allowed under federal law.

#### Medical Savings Accounts

Through 2004, a federal deduction was allowed for contributions to an Archer Medical Savings Account (MSA) by participants in the MSA program; this was also allowed for Wisconsin tax filers. Participation in the MSA program was limited to the self-employed or to persons employed by firms with 50 or fewer employees. Participation also required concurrent enrollment in a high deductible health plan, defined as a health plan with a higher annual deductible than typical health plans and with a maximum limit on the annual amount of out-of-pocket medical expenses that the participant must pay for covered expenses.

Under the MSA program, employer's contributions are excluded from gross income and contributions by individuals are deductible from income. Contributions are limited to 65% of the health insurance deductible for individual plans and 75% of the deductible for family coverage. Distributions from an MSA are excluded from income if used to pay qualified medical expenses, including un-reimbursed medical costs of an eligible MSA participant, and his or her spouse or dependents. MSA distributions may not be used to purchase insurance, except for COBRA-type continuation coverage or long-term health insurance. Distributions used for nonqualified expenses are subject to a 15% penalty, unless the participant is disabled or is age 65 or older.

Beginning in 2004, no new MSAs may be established under federal law, although contributions to existing MSAs will still be allowed. Also beginning in 2004, a federal deduction is allowed for Health Savings Accounts (HSA), although Wisconsin has not adopted the federal HSA provisions.

### **Moving Expenses**

A deduction from gross income is allowed for moving expenses when the move is related to starting work in a new location. Deductible moving expenses include the cost of transporting household goods and personal effects, and the cost of travel to the new residence, including lodging, but not meals.

### **Alimony**

Alimony, separate maintenance or similar periodic payments may be deducted from the gross income of the spouse or former spouse making the payments; however, they are deductible only to the extent that the payments are includible in the gross income of the recipient. Such payments must be made pursuant to a decree of divorce or separation. Child support and property settlements are not considered alimony.

### **Penalty on Early Withdrawal of Savings**

Penalties paid because of premature withdrawal of funds from time savings accounts or deposits may be deducted from gross income. The adjustment is allowed for amounts forfeited to a bank, mutual savings bank, savings and loan association, cooperative bank or homestead association as a penalty for premature withdrawal of funds from a time savings account, certificate of deposit or similar class of deposit. The deduction is not allowed when the loss is incurred in a transaction connected with a trade or business.

## **WISCONSIN MODIFICATIONS TO FEDERAL ADJUSTED GROSS INCOME**

A modification is an addition to or subtraction from federal adjusted gross income authorized by the Wisconsin Statutes to compute Wisconsin adjusted gross income (also referred to as Wisconsin total income). In this report, with the exception of the capital gains add modification discussed in the previous section on "Adjustments to Gross Income," only subtraction modifications are described because only they constitute tax exemption devices.

### **Social Security Benefits: Difference in State and Federal Treatment**

Wisconsin taxes up to 50% of social security benefits, while up to 85% of those benefits are subject to federal tax. A subtract modification allows taxpayers subject to the higher federal taxation to reduce taxable social security to the amount taxable in Wisconsin. The \$51.9 million revenue loss for this modification is in addition to the \$192 million revenue loss from the exclusion discussed in the "Exclusions from Gross Income" section; the total fiscal effect of the state's tax treatment of social security is \$244 million. For taxable years beginning in 2008 or after, Wisconsin will not tax any social security benefits.

### **Interest on U.S. Obligations**

All interest and dividend income, less related expenses, received on obligations of the United States, its territories and the District of Columbia may be subtracted from federal adjusted gross income in determining Wisconsin adjusted gross income. The subtraction applies to interest on obligations issued directly by the federal government and obligations issued by independent agencies, which federal law prohibits states from taxing.

The state taxes interest and dividend income, less related expenses, received from obligations issued by independent agencies that are merely guaranteed by the federal government, provided federal law does not prohibit state taxation. These include bonds issued by the Federal National Mortgage Association, the Government National Mortgage Association, and the Tennessee Valley Authority. The fiscal effect of this exemption is difficult to estimate because a significant portion of these bonds are held indirectly by individuals through mutual funds, partnerships, and other investment vehicles.

### **Capital Gains Deduction**

Wisconsin allows taxpayers to exclude from income 60% of the capital gains on assets held more than one year.

**Capital Gains from Qualified Small Business Stock**

The state excludes from income 100% of the amount of net capital gains from qualified business stock issued on or after January 1, 1986. To qualify for the exclusion, taxpayers must be issued a certification notice by the business, have not acquired the stock as a gift, and hold the stock for a period of at least five years. The criteria for qualified small businesses are listed under Wisconsin Statutes, sec. 71.01 (10). In general, only initial public offerings of small Wisconsin businesses qualify for the exclusion.

**Gains on Sales of Business Assets to Related Persons**

Gains on sales of business assets, including assets used in farming, to persons related to the seller within the third degree of kinship are not subject to tax. These related persons include parents, children, grandparents, grandchildren, brothers and sisters, uncles and aunts, nephews and nieces, and great grandchildren.

**Net Long-Term Capital Losses (Pre-1982)**

Net long-term capital losses from years prior to 1982 that were not allowed as an adjustment to federal gross income in the year a federal net capital loss deduction was taken may be subtracted from federal adjusted gross income. The subtraction is limited to \$3,000 (\$1,500 for married persons filing separately). The unused portion of pre-1982 net long-term capital losses may be carried forward to future years.

Taxpayers deducting pre-1982 net long-term capital losses are not subject to the \$500 state limit on the net capital loss deduction described in the earlier section on "Adjustments to Gross Income".

**Public Pensions**

Payments received from the selected retirement systems by persons who were members of or retired from these systems prior to 1964 are exempt from Wisconsin income; to the extent the payments were included in federal income. The Milwaukee Public School Teachers, Milwaukee City Employees, Milwaukee County Employees, Milwaukee County Sheriff, Milwaukee City Police, Milwaukee Fire Fighters, and Wisconsin Public School Teachers retirement systems, and the U.S. Civil Service and Military Employee retirement system are covered by this exemption.

All payments from the U.S. military retirement system and all U.S. government pension payments received by retirees of the U.S. Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the public health service are exempt.

**State Legislators' Per Diem Expenses**

Amounts received by state legislators as an allowance for expenses incurred while in Madison on legislative business are excluded from Wisconsin adjusted gross income, provided a deduction for travel expenses is not claimed.

**Small Business (Subchapter S) Corporation Subtractions**

A subtraction modification may be allowed to reflect transitional adjustments or differences between the state and federal basis of stock in such corporations. Differences may exist because Wisconsin's treatment of S corporations differed from the federal treatment prior to 1979.

**Distributive Share of Estates and Trusts**

The distributive share of income received from an estate or trust must be adjusted to reflect all Wisconsin modifications to federal adjusted gross income. The distributive share is the beneficiary's portion of income that is distributed from the estate or trust. An example is a taxpayer who receives a total of \$1,500 from a trust, \$300 of which is income derived from interest on U.S. securities. Since federal adjusted gross income includes such interest, the taxpayer subtracts this \$300 to arrive at Wisconsin adjusted gross income.

**Distributive Share of Partnership Modifications**

The distributive share of income received from a partnership must be adjusted to reflect all Wisconsin modifications to federal taxable income. The distributive share is the taxpayer's portion of income from the partnership. An example is a partnership equally distributing \$2,000 in income to two partners, with \$1,000 of the income consisting of interest from U.S. Treasury bills. For federal purposes, each partner receives \$1,000

in taxable income. However, Wisconsin does not tax interest on U.S. Government securities, so each partner subtracts \$500 from federal income to arrive at Wisconsin adjusted gross income. This \$500 is the distributive share of the partnership modifications.

### **Wisconsin Net Operating Loss Carryover**

A net operating loss (NOL) is generally an excess of allowable business deductions over the gross income realized from operations. In determining whether a net operating loss exists, casualty losses are treated as business losses and salary or wages are treated as business income.

In Wisconsin, net operating losses may be carried forward up to 15 years to offset income, and thus reduce tax liability. Federal law allows taxpayers to carry losses back three years or forward 15 in determining taxable income of those years. This difference in federal and Wisconsin carryover periods and other differences in federal and state law may necessitate modifications to federal adjusted gross income to ensure that only Wisconsin business losses are carried forward for state tax purposes. For instance, state and local bond interest and federal NOL carrybacks may be added back to determine the deductible amount of the loss carried forward for Wisconsin purposes.

### **Health Insurance Premiums of the Self-Employed and Certain Employees: Difference in State and Federal Treatment**

Wisconsin allows the self-employed to deduct health insurance premiums for themselves, their spouses and dependents. Additionally, employees whose employer does not contribute towards the cost of their health insurance premiums may deduct 50% of their payments for health insurance in 2005 and 100% beginning in 2006. A deduction is also being phased-in for individuals who are not self-employed and have no employer. For taxable years beginning in 2007 these individuals can deduct 33.4% of health insurance premiums. For 2008 the deduction increases to 66.7% and for 2009 and thereafter it increases to 100%.

The \$4.2 million revenue loss is the amount of loss that occurs because the Wisconsin health insurance premium deductions are more comprehensive than the federal deduction for the self-employed premiums. The revenue loss to the state from the federal deduction for the self-employed is \$21.9 million, so the total fiscal effect of state health insurance deductions is \$26.1 million.

### **Long-Term Care Insurance Expenses**

A deduction is allowed for premiums paid for long-term care insurance. This insurance provides coverage for convalescent or custodial care, or care for a chronic condition or terminal illness that is provided in a person's home, an institution or a community-based setting. Qualified expenses include expenses for policies that cover a taxpayer and his or her spouse. Qualified expenses subtracted from gross income in the calculation of federal adjusted gross income cannot be claimed for this deduction. Also, qualified expenses claimed for this deduction cannot be used to calculate the Wisconsin itemized deduction credit.

### **Constant Basis Assets**

A taxpayer who sold or otherwise disposed of a constant basis asset that has a federal basis different from the Wisconsin basis is required to adjust Wisconsin income to reflect the amount of this difference. This provision applies if the asset was owned prior to January 1, 1965. A constant basis asset is one for which depreciation is not allowed, such as unimproved land.

### **Adjusted Basis of Assets Acquired after January 1, 1965**

A taxpayer who acquires a constant basis asset, such as unimproved land, that has a federal basis different from the Wisconsin basis is required to modify Wisconsin income to reflect the difference in the year that the asset is sold or otherwise disposed of. When a taxpayer acquires a changing basis asset, one for which depreciation is allowed, such as a building, Wisconsin income is modified to reflect differences in the state and federal bases each year, except that the differences may be amortized over a period of five years or less.

This section applies to property acquired after January 1, 1965, for Wisconsin tax purposes. It also generally applies to taxpayers who move into the state and bring certain property with them.

## Unemployment Compensation

Wisconsin excludes from income a portion of unemployment compensation when income falls below certain amounts. Taxable unemployment compensation equals the lesser of total unemployment compensation or 50% of the amount, if any, by which unemployment benefits plus the recipient's adjusted gross income (excluding unemployment compensation and certain disability benefits) exceed specified base amounts. The base amounts are: \$12,000 for single persons and married persons who file separately and lived apart from their spouses for the full tax year; \$18,000 for married persons filing a joint return; and \$0 for married persons who file separately but lived with their spouses for at least part of the tax year.

## Disability Income

A subtraction is allowed for payments to disabled persons that are included in federal income but were excluded under sec. 105 (d) of the Internal Revenue Code prior to its repeal in 1983. This exclusion is limited to individuals who are retired on permanent and total disability, are less than 65 years old, and have FAGI of less than \$20,200 (\$25,400 if married and both spouses are eligible).

## Adoption Expenses

Adoptive parents may deduct adoption fees, court costs or legal fees relating to the legal adoption of a child. This subtraction from federal adjusted gross income is limited to \$5,000 of adoption expenses that occur during the tax year in which the adoption is finalized and the two prior tax years. Employer-paid adoption expenses that under federal law are excluded from gross income may not be used for the deduction.

## Higher Education Tuition Expenses

The federal tax deduction for qualified tuition and fees does not apply in Wisconsin, however, Wisconsin law does allow a tuition deduction. For tax year 2005 a deduction of up to \$4,244 per student per year is allowed for tuition that is paid to any university, college, technical college or a school approved by the Educational Approval Board that is located in Wisconsin. Tuition paid to a public vocational school or public institution of higher education in Minnesota under the Minnesota-Wisconsin reciprocity agreement also qualifies for the deduction. Eligible expenses include tuition for the education of the claimant, the claimant's spouse, and his or her dependent. The maximum deduction amount is phased out in specified ranges of federal adjusted gross income: between \$50,000 and \$60,000 for single and head of household filers, \$80,000 and \$100,000 for married joint filers, and \$40,000 and \$50,000 for married separate filers. The amount of the subtraction is equal to two times the average amount charged to resident undergraduates for academic fees by the University of Wisconsin System at four-year institutions.

## Prepaid Tuition and College Savings Plans

A deduction of up to \$3,000 deduction per year is allowed for contributions to a college savings plan or to an existing prepaid tuition plan operated by EdVest. To prevent double-counting of the deduction, no deduction is allowed for any costs paid out using distributions from such a college savings or prepaid tuition plan. In particular, taxpayers cannot claim a deduction for tuition financed by a distribution from an EdVest account when the contribution to that account was previously deducted.

The deduction is allowed when the beneficiary is the claimant, the claimant's child and dependent, the claimant's grandchild, great-grandchild, niece or nephew.

In addition, any interest earnings on contributions to an EdVest plan may be deducted, to the extent these earnings are included in federal adjusted gross income and provided that the distributions from the plan are used for qualified educational purposes. Distributions from these plans are exempt from federal tax.

The prepaid tuition program is limited to University of Wisconsin System schools and Minnesota schools included under the Minnesota-Wisconsin tuition reciprocity agreement. The college savings plan allows individuals to purchase tuition units that apply toward tuition or other costs at any institution of higher education in the United States.



### **Human Organ Donation Expenses**

An individual who, while living, donates one or more of his or her human organs to another human being for human organ transplantation may subtract \$10,000 from federal adjusted gross income in the year in which the transplant occurs. The subtract modification may only be claimed for travel expenses, lodging expenses, and lost wages that are incurred by the claimant and related to his or her organ donation.

### **Active Duty Military Income**

Members of the reserves or National Guard components of the U.S. armed forces who are called to federal active duty, may deduct from FAGI the amount of military pay received that relates to the period of time during which they are on active duty. Military income received while on active duty and serving in a combat zone is already excluded from income and therefore may not be deducted from FAGI. Military pay deducted from income may not be used in claiming the armed forces member tax credit.

## **DEDUCTIONS AND EXEMPTIONS FROM WISCONSIN ADJUSTED GROSS INCOME**

A deduction is an amount subtracted from Wisconsin adjusted gross income (or total income) to yield Wisconsin taxable income – the amount to which the tax rates are applied. Federal taxpayers may claim either a standard deduction or an itemized deduction. Wisconsin taxpayers are allowed a standard deduction only, though taxpayers may be eligible for an itemized deductions credit, explained in the next section. Wisconsin also provides a personal exemption that is subtracted from Wisconsin adjusted gross income.

### **Standard Deduction**

Wisconsin provides a sliding scale standard deduction that decreases as income increases. For tax year 2005, the standard deduction for single persons was \$8,170 when Wisconsin adjusted gross income (WAGI) was less than \$11,770, and it was phased out as WAGI rose from \$11,770 to \$79,853. For heads of households, mostly single parents, the deduction was \$10,550 when WAGI was less than \$11,770, and it was phased down to the level of the standard deduction of single filers as WAGI rose from \$11,770 to \$34,404. When WAGI exceeded \$34,404, heads of households received the same deduction as single filers. For joint filers, the standard deduction was \$14,710 when WAGI was less than \$16,520 and was phased out when WAGI was between \$16,520 and \$90,895. For married persons filing separately, the standard deduction was \$6,990 when WAGI was less than \$7,850 and was phased out when WAGI was between \$7,850 and \$43,192. These amounts are indexed for inflation.

The estimate of revenue loss for the standard deduction does not reflect the amount of the itemized deductions credit that would be claimed by persons not currently claiming it if the standard deduction was eliminated; the credit cannot be calculated because the amount of their itemized deductions are not known for all taxpayers.

### **Personal Exemption and Additional Elderly Exemption**

Wisconsin provides an exemption equal to \$700 for each tax filer, spouse and dependent, plus an additional exemption of \$250 for each taxpayer and spouse age 65 and older.

## **WISCONSIN CREDITS**

A credit is an amount that is subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rates to Wisconsin taxable income) to determine the Wisconsin net tax liability. A credit can be nonrefundable or refundable. A nonrefundable credit is limited to the amount of income tax otherwise due; it cannot be used to reduce taxes to less than \$0. A refundable credit is paid to claimants in the form of a refund check when the amount of the credit exceeds the tax otherwise due.

### **Itemized Deductions Credit**

Federal law allows itemized deductions to be subtracted from federal adjusted gross income when these deductions exceed the federal standard deduction. Wisconsin does not allow itemized deductions, but instead has a nonrefundable credit for some of the expenses for which federal itemized deductions may be claimed. This credit is equal to 5% of the eligible itemized deductions in excess of Wisconsin's sliding scale standard deduction. The eligible expenses include medical expenses, interest, and charitable contributions. No credit is allowed for the federal itemized deductions for state and local taxes, casualty and theft losses, and miscellaneous expenses.

The expenses used in calculating the Wisconsin itemized deductions credit are described below, and their fiscal effects are estimated. The sum of these estimates for each particular expense exceeds the total fiscal effect for the itemized deductions credit because of interaction effects.

### 1. Medical Expenses

Most health expenses can be claimed as an itemized deduction to the extent that the total amount of medical expenses not compensated for by insurance exceeds 7.5% of the taxpayer's federal adjusted gross income. Eligible expenses include: fees for doctors, dentists, health practitioners and hospital services; amounts spent for prescription medicine and drugs; premiums paid on medical or health insurance policies; costs of medical equipment (e.g. motorized wheelchairs, hearing aids, dentures, eye glasses); and the cost of transportation, meals, and lodging for needed medical care. The credit for medical expenses reduced tax revenues by \$28.8 million in FY06.

### 2. Interest

Mortgage interest on a primary personal residence located in Wisconsin qualifies for the state's itemized deductions credit. Wisconsin also allows the credit for interest paid on indebtedness related to investments to the extent that the investment interest is offset by the taxpayer's net investment income and to the extent that income is subject to Wisconsin tax. The revenue loss from the credit for interest expense was \$215 million in FY06.

Interest paid on indebtedness related to business, rental, and royalty property is subtracted separately in determining the net income from the business, rental or royalty activity; see the section on "Deductions Which Further Define Net Income."

### 3. Charitable Contributions

Contributions to recognized charitable organizations or activities can be claimed as an itemized deduction. In general, a recognized charity is any governmental body or any public or private corporation, trust or foundation organized and operated principally for charitable, religious, scientific, literary or educational purposes. Certain limitations apply on contributions of property or the taxpayer's personal services. Additional limitations apply on the total amount of charitable contributions that can be deducted within a single year. The revenue loss from the credit for charitable contributions was \$102 million in FY06.

### School Property Tax Credit

The school property tax credit is equal to 12% of the first \$2,500 of property taxes or rent constituting property taxes paid on a person's primary residence and contiguous land, up to a maximum credit of \$300. For renters, "rent constituting property taxes" means 25% of rent if heat is not included or 20% of rent if heat is included in rent. No credit is allowed for property taxes or rent that is deductible as a trade or business expense. The credit is nonrefundable.

### Working Families Credit

The working families credit equals a taxpayer's net tax liability, defined as gross tax less the itemized deductions, school property tax, and historic rehabilitation credits, when income is less than \$18,000 for married couples filing jointly and \$9,000 for other tax filers. Essentially, the credit eliminates tax liability when income is below these ceilings. The credit is phased out over the next \$1,000 of income above these ceilings. The credit is limited to full-year residents and no credit is allowed for persons who are claimed as a dependent on another filer's tax return. It is nonrefundable.

### Married Couple Credit

Wisconsin provides a nonrefundable credit for married couples when both spouses are working to offset the marriage tax penalty facing two-earner couples. A penalty occurs when a married couple pays more tax than what they would if the two spouses were taxed as two single filers. The credit equals 3% of the first \$16,000 of earnings, resulting in a maximum credit of \$480.

### **Armed Forces Member Credit**

Wisconsin allows a nonrefundable credit of up to \$300 for military pay received for service while stationed outside the United States; to the extent this pay is included in WAGI. If both spouses of a married couple filing jointly receive pay for military service outside the country, each may claim the \$300 credit. The credit is allowed for full-year residents of Wisconsin only.

### **Development Zone Credits**

Development zone credits are available to taxpayers who are certified by the Department of Commerce to participate in the Wisconsin development zone program. Credits awarded to non-corporate entities are passed through to their owners in proportion to their ownership interest in the entity, and may be claimed on the owner's individual income tax return. These credits are nonrefundable, so they are limited to tax liability otherwise due, however unused amounts may be carried forward. This program and the credits are more fully discussed in the chapter on "Corporate Income and Franchise Taxes."

### **Angel Investment Credit and Early Stage Seed Investment Credit**

The angel investment credit is available to individuals for investments in qualified new business ventures certified by the Department of Commerce. A credit for 12.5% of the investment may be claimed in each taxable year for two years. The maximum amount eligible for the credit is \$500,000 for each investment. The amount of credit that may be claimed by all taxpayers in any taxable year is limited to \$3 million and the total amount of credits that may be claimed for all taxable years is \$30 million. It is nonrefundable.

Also beginning in tax year 2005, the early stage seed investment credit is available for businesses and individuals for 25% of qualified investments, with a maximum credit of \$3.5 million per taxable year and \$35 million for all taxable years. A more detailed description of the credit can be found in the Corporate Income and Franchise Tax chapter.

Both credits expire after tax year 2014.

### **Historic Preservation Credits**

Two nonrefundable credits are provided to encourage the rehabilitation of historic buildings in Wisconsin.

#### **1. Supplement to the Federal Historic Rehabilitation Credit**

The supplement to the federal historic rehabilitation credit, equal to 5% of qualified rehabilitation expenditures, may be claimed for projects eligible for the federal credit. Qualified rehabilitation expenditures, defined under sec. 48 (g) of the Internal Revenue Code, are expenditures to substantially rehabilitate certified historic buildings for use in a trade or business. The rehabilitation work must meet historic preservation standards and the expenditures must exceed the taxpayer's adjusted basis in the building. Unused amounts of the credit may be carried forward for up to 15 years. The credit applies only to property located in Wisconsin. Taxpayers must reduce their Wisconsin adjusted basis in the building by the amount of the credit claimed. The reduced basis will result in lower depreciation deductions.

For rehabilitation projects undertaken by a partnership, tax-option corporation or limited liability company (LLC), the credit is passed through to the individual partners, shareholders or members in proportion to their ownership interest in the partnership, corporation or LLC.

#### **2. State Historic Rehabilitation Credit**

The state historic rehabilitation credit is equal to 25% of qualified expenditures to substantially rehabilitate certified historic buildings for noncommercial use. The credit applies to owner-occupied personal residences, provided that the residence is not used in the course of a trade or business. The credit cannot be claimed for rehabilitation of a personal residence if the person has already claimed a rehabilitation credit for another personal residence within the preceding five years. The rehabilitation work must meet historic preservation standards and the expenditures must exceed \$10,000. The maximum credit amount is \$10,000 (\$5,000 for married persons filing separately). Unused amounts of credit can be carried forward for up to 15 years. The credit applies only to property located in Wisconsin.

Taxpayers must reduce their Wisconsin adjusted basis in the building (or entire property, if not a building) by the amount of the credit claimed. The reduced basis will have the result that taxpayers may have an increased taxable gain from the sale or exchange of the property.

### **Dairy and Livestock Farm Investment Credit**

For taxable years beginning after 2005 and before 2012, a nonrefundable credit is available for 10% of certain expenditures to modernize or expand a dairy or livestock farm. The maximum amount of the credit that can be claimed is \$50,000. This credit is discussed in more detail in the corporate income and franchise tax chapter of this report.

### **Earned Income Credit**

Wisconsin allows low-income workers with dependents to claim a Wisconsin earned income credit equal to a percentage of the federal earned income tax credit, depending on family size. The credit is refundable; any amount of the credit in excess of taxes otherwise due is rebated to the taxpayer.

The Wisconsin credit is 4% of the federal credit for persons with one child, 14% for persons with two children, and 43% for persons with three or more children. For persons with one child the 2005 federal credit was 34% of the first \$7,830 of earnings, and for persons with two or more children the credit was 40% of the first \$11,000 of earnings. These federal credits were phased out as the greater of earnings or federal adjusted gross income rose from \$14,370 to \$31,030 for single persons with one child and from \$14,370 to \$35,263 for single persons with two or more children. The phase-out floors and ceilings are \$2,000 higher for married couples who file joint returns and they are scheduled to be \$3,000 higher for tax years after 2007. The maximum credit and the range over which the credit is phased out are indexed to inflation.

Federal law also allows a credit for low-income workers without children; Wisconsin has no similar credit.

### **Homestead Credit**

Low-income homeowners and renters may qualify for a refundable income tax credit based on household income and property taxes or rent constituting property taxes. To qualify, the person:

1. Must be 18 years of age or older by the last day of the calendar year;
2. Must not be claimed as a dependent on anyone else's federal income tax return (unless the claimant is 62 years of age or older);
3. Must be a legal resident of Wisconsin for the entire calendar year;
4. Must have household income (of the claimant and spouse) of less than \$24,500. Household income includes both taxable and nontaxable sources.

In addition, persons are ineligible for the credit if they:

1. Live in a nursing home and receive medical assistance (Title XIX) at the time of filing the claim;
2. Live the entire year in housing that is exempt from property taxes;
3. Claim the farmland preservation credit or the veterans and surviving spouse property tax credit for their home; or
4. Receive general relief payments of \$400 or more for each month of the year of claim, or public assistance (Aid to Families with Dependent Children or Temporary Assistance for Needy Families) for the entire year of claim.

For renters, property taxes are assumed to be 20% of rent if heat is included or 25% of rent if heat is not included in the rent. In computing household income, a claimant may deduct \$250 for each dependent living with the claimant.

For claims filed in 2005, the amount of credit was determined as follows:

1. If household income was \$8,000 or less, the credit was 80% of property taxes up to \$1,450; thus, the maximum credit was \$1,160.
2. If household income exceeded \$8,000 but was no more than \$24,500, the credit was 80% of the amount by which property taxes exceeded 8.778% of household income in excess of \$8,000. That is, the credit is 80% of property taxes up to a maximum credit of \$1,160. The credit is phased out at a rate of 7.0224% (80% multiplied by 8.778%) when household income exceeds \$8,000.
3. If household income exceeded \$24,500, no homestead credit was allowed.

### **Income Taxes Paid to Other States/Income Tax Reciprocity**

If a person lives in one state and is employed in another, income may be subject to taxation in both states. To alleviate this double taxation, the state in which the taxpayer resides may allow a credit for income taxes paid to another state. Alternatively, two states may enter into a reciprocity agreement whereby the taxpayer is only required to pay state income taxes to the home state. Currently, Wisconsin has reciprocity agreements with Illinois, Indiana, Kentucky, Michigan and Minnesota.

#### **1. Credit for Taxes Paid to Other States**

Wisconsin residents may reduce their Wisconsin income tax by the amount of income taxes paid to other states (or the District of Columbia). The credit is not allowed if wages are earned in states having reciprocity agreements with Wisconsin. The revenue loss from this credit was \$102 million in FY06. The credit is refundable.

#### **2. Income Tax Reciprocity**

Since there are more Wisconsin residents employed in Minnesota and Illinois than residents of those two states working in Wisconsin, the income tax revenue foregone by those two states exceeds the taxes foregone by Wisconsin as a result of reciprocity. Either state could capture these additional revenues by eliminating reciprocity, but that would require individuals living in one state and working in the other to file income tax returns with both states. To avoid this and to eliminate the need for credits for taxes paid to the other state, Wisconsin has agreed to pay both Minnesota and Illinois an amount equal to the tax each state foregoes in excess of the amount of tax Wisconsin foregoes as a result of reciprocity. The payment to Minnesota includes interest calculated from July 1 of the tax year for which the payment is made until the date of the payment. Payments in FY06 were \$57,000,000 to Minnesota and \$32,000,000 to Illinois.

### **Claim of Right Credit**

A taxpayer who repays income in the current year that had been subject to tax in a previous year may claim a refundable credit for the amount of tax paid on that income in the previous year.

### **Farmland Tax Relief Credit**

A farmland tax relief credit equal to a percentage of property taxes on farmland, exclusive of improvements, is provided to owners of farmland. The Department of Revenue sets the credit percentage and amount of eligible property taxes so that the maximum credit is \$1,500 and total expenditure on the credit for all claimants, individual and corporate, is \$15 million, adjusted for expenditures in excess of or less than this amount in the prior fiscal year. For tax year 2005, the credit rate was 20% of the first \$7,500 of property taxes.

No credit is allowed for property taxes on farm buildings or other improvements on the farmland. The credit is refundable. To be eligible for the credit, the claimant must be domiciled in the state for the entire year and own the property on which the claim is based. This farmland must be at least 35 acres and be part of a farm that produces gross profits of at least \$6,000 in the year the credit is claimed, or \$18,000 in total for the year the credit is claimed and the two prior years.

**Farmland Preservation Credit**

The Farmland Preservation Credit program allows owners of Wisconsin farmland to reduce their state income tax liability by a percentage of the property taxes paid on the land. The purpose of the credit is to encourage farmers to keep their land in agricultural use.

To be eligible for the credit, the following conditions must be met:

1. The claimant must be a resident of the state for the entire year for which the credit is claimed and must own the land for which the credit is claimed.
2. The farmland upon which the claim is based must be zoned exclusively for agricultural use or the claimant must have signed a farmland preservation agreement.
3. The farmland on which the claim is based must be at least 35 acres and must produce at least \$6,000 in gross farm receipts in the year for which the credit is claimed, or a total of \$18,000 in gross farm receipts in the year for which the credit is claimed and the two preceding years. If at least 35 acres of the farmland is enrolled in the federal Conservation Reserve Program, the farmland does not have to meet the gross farm receipts test.
4. The claimant or his or her spouse may not claim a homestead credit for the same period as that for which the farmland credit is claimed. In addition, only one member of a household may claim the farmland credit.
5. The claimant must certify that all taxes owed by the claimant on the farmland for the year before the year for which the claim is made have been paid.
6. The claimant must be in compliance with county soil and water conservation standards.

The credit amount is calculated as follows:

1. Household income is computed.
2. Excess property tax is calculated as shown in the table below where allowable property tax is the lesser of the claimant's property tax bill or \$6,000.

**TABLE 4  
EXCESS PROPERTY TAX CALCULATION**

If household income is: over-                      but not over-	The excess property tax is the amount by which allowable property tax exceeds:
-                      \$5,000	\$0
5,000                      10,000	7% of household income - \$350
10,000                      15,000	9% of household income - \$550
15,000                      20,000	11% of household income - \$850
20,000                      25,000	17% of household income - \$2050
25,000                      30,000	27% of household income - \$4550
30,000                      36,621	37% of household income - \$7550
36,621                      -	\$6000

3. Using the excess property tax, the potential credit is calculated according to the table below. Excess property tax cannot exceed \$6,000.

**TABLE 5  
POTENTIAL CREDIT CALCULATION**

If excess property tax is:		The potential credit is:
over-	but not over-	
\$0	\$2,000	90% of excess property tax
2,000	4,000	70% of excess property tax + \$400
4,000	6,000	50% of excess property tax + \$1,200

4. The claimant's calculated credit is 70%, 80% or 100% of the potential credit, depending on whether the claimant has a farmland preservation agreement or participates in the program through zoning and on the type of action the county and municipality have taken on the agricultural preservation plan or zoning ordinance. The Department of Agriculture, Trade and Consumer Protection can inform claimants of the percentage they can expect to receive.
5. Finally, the claimant's Farmland Preservation Credit is equal to the smaller of the calculated credit and a special minimum credit equal to 10% of the allowable property tax. In addition, the total of a claimant's farmland preservation credit and farmland tax relief credit cannot exceed 95% of the farmland property taxes.

The amount of any Farmland Preservation Credit received is treated as income for Wisconsin tax purposes and must be reported as such on the claimant's tax return for the year in which it is received. The reason for this treatment is that property taxes on farmland are a deductible business expense that the farmland owner has already claimed as a deduction in calculating federal adjusted gross income. The credit is added back to reduce the deduction to the amount actually paid by the landowner, that is, the amount of the tax less the credit.

Under certain circumstances, if a farmland owner removes land from the Farmland Preservation Program, tax credits received on the land for the preceding 10 years, including interest on the credits, must be repaid.

**Veterans and Surviving Spouses Property Tax Credit**

Eligible veterans and surviving spouses may claim this refundable credit in the amount of the property taxes paid during the year on the claimant's principal dwelling in Wisconsin. To be eligible for the credit, veterans must be at least 65 years of age and verified by the Wisconsin Department of Veterans Affairs as having served in the U.S. armed forces, having been a Wisconsin resident at the time of entry into service, currently being a Wisconsin resident for the purpose of veterans benefits, and having a service-connected disability rating of 100%. An eligible surviving spouse must be an un-remarried surviving spouse of an individual who was a Wisconsin resident at the time of entry into service, was a Wisconsin resident at the time of death and died while on active duty or would be otherwise considered an eligible veteran at the time of death. The cost of this credit for fiscal year 2006 was \$658,000, but this may not reflect ongoing costs as awareness of the credit increases and individuals change their filing behavior.

**DEDUCTIONS WHICH FURTHER DEFINE NET INCOME**

This report estimates the cost to the state of providing exemptions from the income tax for items that would otherwise be taxable. In earning a trade or business income, certain expenses are necessarily incurred and individuals are allowed to deduct these expenses in determining the net income from the trade or business subject to tax. These deductions are described below, but their fiscal effect is not estimated because they are not truly exemption devices. Rather, they are used to define net income upon which the income tax is imposed.

**Trade and Business Expenses**

A deduction from gross income is allowed for the ordinary and necessary expenses that are directly attributable to a trade or business carried on by the taxpayer. Services by the taxpayer as an employee are not considered a trade or business. Examples of expenditures normally allowed as deductions include: employee compensation and benefits, the cost of operations, fuel and electricity, advertising expenses, interest paid, insurance, legal fees, bad debts, depreciation, amortization, and depletion.

**Employee's Trade and Business Expenses**

Employees are allowed to deduct from gross income certain trade and business expenses that are incurred in the performance of job-related services for their employers. For purposes of computing adjusted gross income, the deduction is limited to:

1. All costs (including entertainment expenses) incurred in connection with one's job for which reimbursement is received either through an expense allowance or some other means. Amounts constituting reimbursement for employee expenses must be included in gross income in most instances.
2. Travel expenses whether or not reimbursement is received for them. They include the cost of transportation, meals, lodging and the use of certain services, e.g. telephone services.
3. All business expenses of an outside salesperson, defined as an individual who solicits business as a full-time salesperson away from his or her employer's place of business. This deduction would cover items such as insurance, depreciation on an automobile or other vehicle, food, lodging, telephone charges, and entertainment.

Federal regulations provide that if an employee receives a reimbursement exactly equal to his expenses and makes a sufficient accounting to the employer, he need not report the reimbursement as gross income, in which case none of the expenses may be deducted in determining adjusted gross income.

**Expenses Related to Rent and Royalty Income**

The expenses related to rent and royalty income are deductible from gross income. These expenses include taxes, interest, depletion, depreciation, and other expenses such as repairs, employee wages, utilities, insurance, and losses.



## CORPORATE INCOME AND FRANCHISE TAX

Taxation of corporate income was enacted in Wisconsin in 1911, at the same time the individual income tax was created. Since its initial enactment, the corporate tax has undergone some noteworthy changes: a shift from graduated rates to a flat rate in 1981, federalization of the tax base in 1987, and a phase-in of a single sales factor beginning in 2006. In 1981, a series of rates and brackets were replaced with a single flat rate of 7.9%. Under the federalized state corporate tax in effect since 1987, corporate taxpayers are subject to tax on the Wisconsin apportioned share of their federal net taxable income, with a limited number of adjustments for the relatively few remaining federal/state law differences and the ongoing effects of previous law differences. Corporations that conduct business in more than one state must apportion their net income among the states with jurisdiction to tax the income. Until 2006, Wisconsin apportioned income with a formula based on three factors — property, payroll, and sales. In the formula, the sales factor was double-weighted (50%) and the property and payroll factors were single-weighted (25% each). For taxable years beginning in 2006, an apportionment formula based solely on the sales factor will be phased in, with full implementation of the single sales formula beginning in 2008.

Corporations are actually subject to one of two state taxes. The corporate *income* tax, imposed since 1911, is a tax on the net income of corporations doing business in the state. The corporate *franchise* tax, imposed since 1965, is a tax on the privilege of doing business in the state. Corporate net income is used as the measure or base for the franchise tax. The distinction between the two taxes is a subtle one, relating primarily to the restrictions under federal law on the types of income that states can tax with an income tax (e.g., interest from U.S. obligations). The vast majority of corporations pay the franchise tax. The income tax applies to corporations whose business in Wisconsin consists entirely of foreign or interstate commerce and corporations that are filing their final return before dissolution. Because both levies employ the same rate and the same general rules for determining corporate net income (although interest income from U.S. obligations cannot be taxed under the income tax), the two taxes are usually considered as one.

Wisconsin also imposes a recycling surcharge equal to 3% of the gross tax liability of regular (C) corporations and 0.2% of the net income of tax-option (S) corporations and other business entities. The surcharge and its exemptions are treated in a separate chapter.

Wisconsin provides for differential tax treatment of business income depending on the form of organization under which a business or organization operates. The business income of proprietorships and partnerships is reported and taxed on the individual income tax returns filed by the owners of the business. Tax-option or Subchapter S corporations are corporations that have elected under Subchapter S of the Internal Revenue Code to have their business income taxed to the individual owners of the business in essentially the same manner as a partnership.

Businesses that are organized as regular, or Subchapter C, corporations pay the corporate income/franchise tax. In addition, under certain circumstances, the business income of nonprofit organizations and certain types of trusts can be subject to the state corporate tax.

Wisconsin Act 112 (1993) authorized the formation of a new form of business organization, the limited liability company (LLC). LLCs combine the limited liability protection afforded to owners of corporations with the flow-through tax benefits provided to owners of S corporations and partners in partnerships. Generally, business income of LLCs is reported and taxed on the individual income tax returns of the owners (called members) of the business. However, some LLCs choose to be taxed as corporations and their business income is reported on the corporate return.

### Collections

In FY06, corporate tax collections were \$780.3 million or 6.5% of total general purpose revenue (GPR) taxes. Although corporate tax collections continue to be a major source of revenue for the state, they have declined as a share of total state tax revenues. Enactment and expansion of the state sales tax and growth of the individual income tax have reduced the relative importance of the corporate tax as a revenue source.

### Data Sources

Tax exemption devices applicable to the corporate income tax are grouped into five categories: exemptions, exclusions, special treatments, deductions, and credits. The following data sources were used to estimate the fiscal effects of these exemption devices.

1. Wisconsin Corporate Income Tax Model. Fiscal estimates were based in part on data and analysis provided

by a computerized corporate income and franchise tax model. Like the Individual Income Tax Model, the corporate model depends on scientifically selected samples of returns from state taxpayers. The model contains more than 5,000 corporate returns for tax year 2003, weighted to reflect the corporate tax filing population.

2. Wisconsin Corporate Tax Collection Statistics. Department of Revenue annual aggregate statistics of corporate tax collections and data from individual corporate returns were also used to estimate fiscal effects.
3. Federal Tax Expenditure Estimates. The Congressional Budget Act of 1974 requires preparation of a federal tax expenditure budget annually. These "expenditures" reflect the cost in lost federal revenues of the wide variety of exemptions and incentives contained in the Internal Revenue Code. Using Congressional Budget Office, Joint Tax Committee, and U.S. Department of Treasury figures, estimates of the fiscal effect of comparable provisions contained in state law were generated. The procedure followed was first to apportion the federal tax expenditure to Wisconsin and then to adjust for the difference in state and federal tax rates.
4. Statistics of Income, *Corporation Income Tax Returns*. Published annually by the Internal Revenue Service, this document provides aggregate data for income and deduction amounts reported on federal returns. By apportioning the appropriate figures to Wisconsin using the 0.99% ratio of Wisconsin corporate income to U.S. income and applying a marginal rate of 7.9%, fiscal estimates for some exemptions were obtained.
5. Miscellaneous Sources. Federal and state government agencies which publish data relating to the corporate sector provided additional information.

Several methodological issues complicate the estimation of the revenue loss associated with corporate tax exemption devices. The major obstacle is the lack of useful data. When data are available, they often only approximate the exempt income or deductible expenses for which an estimate is being made. Data may be several years old, which reduces its usefulness given the potential volatility in economic conditions across the nation, within the state, or within a particular industrial sector. Interest rates, price levels, industrial reorganizations, and many other factors contribute to this volatility. Further, the corporate tax is imposed on corporate profits, which can be highly variable. Finally, the estimation process requires assumptions, for example, on Wisconsin's share of some national aggregate or the profitability of corporations operating in Wisconsin relative to firms nationwide. Frequently there is limited information on which to base these assumptions, so they may introduce errors into calculations.

**TABLE 1**  
**CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY06 Fiscal Effect
<b>Exemptions from Taxation</b>		
Governmental Units	s. 71.26 (1)(b) and (bm)	None
Nonprofit Corporations or Associations	s. 71.26 (a)	
Nonprofit Organizations		None
Private Foundations		\$19,700,000 <sup>1</sup>
Cooperatives	s. 71.26 (1)(c)	None
Credit Unions	s. 71.26 (1)(a)	6,370,000
Insurance Companies	s. 71.43 (2) and 71.45 (1)	Not available
Banks Under Liquidation	s. 71.26 (1)(d)	Minimal
Assets Distributed to the Menomonee Indian Tribe	s. 71.26 (1)(e)	Minimal
Activities of Out-of-State Publishers and Certain Foreign Corporations	s. 71.23 (3)	Not available
<b>Exclusions From Income</b>		
Life Insurance Proceeds	IRC 101	Minimal
Exchanges of Corporate Property or Stock	IRC 1031 to 1033 and 1036 to 1038	
Like-Kind Exchanges		2,900,000
Other Exchanges		Not available
Recovery of Bad Debts, Prior Taxes and Delinquency Amounts	IRC 111	Minimal
Natural Resource-Related Cost-Sharing Payments	IRC 126	Minimal
Statutory Reference*		
<b>Special Treatment</b>		
Limit on Tax Liability of Insurers	s. 71.46 (3)	19,300,000 <sup>2</sup>
Urban Mass Transportation Companies	s. 71.39	None
RICs, REITs and REMICs	IRC 851 to 860 and 860A to 860G, s. 71.26 (2)(b)	Minimal

**TABLE 1 (continued)  
CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY06 Fiscal Effect
Apportionment of Income	s. 71.25 (6)	15,600,000 <sup>2</sup>
"Throwback" Sales	s. 71.25 (9)(b)2m and 3, and (9)(c)	11,800,000 <sup>2</sup>
Tax-Option Corporations	IRC 1361 to 1368 and 1374, ss. 71.32 to 71.365	Not available
Limited Liability Companies	ss. 71.19 to 71.21 and ch. 183	Unknown
Unincorporated Cooperative Associations	ss. 71.26 (1) (c) and ch. 193	None
<b>Deductions from Gross Income</b>		
Amortization and Other Special Cost Recovery Allowances:	IRC 169, 173 to 175, 178, 180, 190, 193 to 195, 263(c), 291, 611, 612, 616 and 617	Minimal
Circulation Expenditures		15,240,000
R&D Expenditures		Not available
Conservation Expenditures		Minimal
Lease Acquisition		Minimal
Fertilizer Expenditures		Minimal
Disabled Access Expenditures		Minimal
Tertiary Injectants		Minimal
Reforestation Expenditures		300,000
Start-Up Expenditures		Minimal
Intangible Drilling Costs		Minimal
Mine Exploration		Not available
Other Amortization		4,400,000
Charitable Contributions		IRC 170
Depreciation—Accelerated and Modified Cost Recovery System and Expensing Election	IRC 167, 168 and 179 s. 71.26(3)(y)	Not available
Accelerated Recovery		Not available
Section 179 Expensing		Not available
Dividends	IRC 591 and 1382; s. 71.26 (3)(j)	Not available
Dividends Received		Not available
Patronage Dividends		Not available
Depositor's Dividends		Not available
<b>Deductions from Gross Income, continued</b>		
Bad Debt Reserves of Financial Institutions	IRC 585 and 593	70,000
Net Operating Loss Carryforward	s. 71.26 (4)	115,300,000 <sup>2</sup>
Qualified Production Activities	IRC 199	9,400,000
<b>Credits</b>		
Credit for Sales Tax on Fuel and Electricity Used in Manufacturing	ss. 71.28 (3) and 71.47 (3)	27,200,000 <sup>3</sup>
Manufacturing Investment Credit	ss. 71.28 (3t) and 71.47 (3t)	See Footnote 4
Research Expenditures Credit	ss. 71.28 (4) and 71.47 (4)	17,300,000 <sup>3</sup>
Research Facilities Credit	ss. 71.28 (5) and 71.47 (5)	1,200,000 <sup>3</sup>
Supplement to Federal Historic Rehabilitation Credit	ss. 71.28 (6) and 71.47 (6)	330,000 <sup>3</sup>
Development Zone, Airport Development Zone, Development Opportunity Zone, Enterprise Zone Jobs Credit, Enterprise Development Zone and Agricultural Development Zone Credits	ss. 71.28 (1dx), (1dm), (1di), (3w) and 71.47 (1dx), (1dm) (1di), (3w)	4,800,000 <sup>3</sup>

**TABLE 1 (continued)**  
**CORPORATE INCOME AND FRANCHISE TAX EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY06 Fiscal Effect
Dairy and Livestock Farm Investment Credit	ss. 71.28 (3n) and 71.47 (3n)	960,000 <sup>3</sup>
Technology Zone Credit	ss. 71.28 (3g) and 71.47 (3g)	330,000 <sup>3</sup>
Early Stage Seed Investment Credit	ss. 71.28 (5b) and 71.47 (5b)	Minimal
Farmland Tax Relief Credit	ss. 71.28 (2m) and 71.47 (2m)	234,000 <sup>3</sup>
Farmland Preservation Credit	ss. 71.28 (2), 71.47 (2) and 71.57 to 71.61	167,000 <sup>3</sup>
Community Development Finance Credit	ss. 71.28 (1) and 71.47 (1)	Minimal
Insurance Security Fund Assessments	s. 646.51 (7)	None
Film Production Credits	ss. 71.28 (5f), (5h), and 71.47 (5f), (5h)	See Footnote 4
Broadband Internet Equipment Credit	ss. 71.28 (5e) and 71.47 (5e)	See Footnote 4
Health Insurance Risk-sharing Pool Assessment Credit	ss. 71.28 (5g) and 71.47 (5g)	See Footnote 4

\* Note: References to sections of the 2005 Wisconsin Statutes, except "IRC" indicates a reference to a section of the federal Internal Revenue Code authorizing the exemption device.

1. Data is for Federal Fiscal Year 2003, the most recent data available.
2. Data is for State Fiscal Year 2005, the most recent data available.
3. Amount is for credit taken. Additional amounts may have been claimed but carried forward.
4. The provision does not take effect until after FY 2006. Therefore there is no FY06 fiscal effect.

## EXEMPTIONS FROM TAXATION

An exemption allows certain types of organizations, or certain activities related to those organizations, to be free of Wisconsin corporate franchise or income taxes.

### Governmental Units

All political units are exempt from income taxation. This includes the federal and state governments, counties, cities, towns, villages, school districts, technical college districts, and special governmental districts like sewerage treatment districts and family care districts. Also exempt are quasi-governmental districts formed for some special public purpose, including local exposition, professional baseball park, professional football stadium, and local cultural arts districts.

Under the provisions of the United States Constitution, states cannot tax the assets or income-generating activities of the federal government. The state does not tax the assets or income-generating activities of local governments. Defining the net income of local government activities would be difficult, since such activities are generally not trades or businesses. In the case of activities that could be considered trades or businesses, such as municipal water utilities or public golf courses, the activities rarely result in net income to the local government.

### Nonprofit Corporations or Associations

All religious, scientific, educational, benevolent or other corporations or associations not organized or operated for profit are exempt from taxation on income from activities related to their tax-exempt purpose. Examples include college alumni groups, scouting organizations, religious and other not-for-profit nursing homes, community-based fund-raising drives for the needy, public interest research groups, and foundations.

Nonprofit organizations with income from business activities that are not related to their tax-exempt purpose are subject to a corporate-level unrelated business income tax (UBIT) similar to the federal UBIT. Certain types of income, such as royalties, are not included in UBIT.

Nonprofit organizations are not subject to tax on income from contributions and business activities related to their tax-exempt purpose because this income is used to provide the public services for which these organizations exist. The fiscal effect from this exemption is shown to be zero because if nonprofits were subject to tax, they would have little or no income subject to tax.

Private foundations are treated differently since their activities tend to be more restricted than tax-exempt nonprofit organizations. Foundations generally do not conduct activities; rather, they provide grants to other organizations to conduct the activities. Thus, the investment income of foundations greatly exceeds their low

amount of operating costs. The net investment income for these private foundations is exempt from the income and franchise taxes under Wisconsin law. Since 1969, the federal government has imposed an annual excise tax on the net investment income of private foundations and a series of penalty levies linked to the failure of foundations to meet certain specified operating requirements. The state does not impose a similar annual excise tax on private foundations.

### **Cooperatives**

Cooperatives organized under Chapter 185 of the Wisconsin Statutes are exempt from income taxation, provided they operate without profit to any shareholder or member and distribute their proceeds according to the procedures set out in sec. 185.45, Wis. Stats. Cooperatives may be organized for any lawful purpose except banking or insurance.

Agricultural cooperatives engaged in marketing farm products for producers and associations or corporations that process and market farm products for such cooperatives are exempt from income taxation. To retain their exempt status, cooperatives must: (1) have at least 25 members, (2) return to producers the net proceeds resulting from sale of their products, and (3) in the preceding five years have limited payments of members' dividends to no more than 8% of the value of the stock per year. Corporations that process and market farm products for agricultural co-ops are additionally required to deal solely in farm products and cannot charge more than a sufficient amount to cover the costs of: (1) marketing and processing, (2) payment of dividends not to exceed 8% of the value of the cooperative's stock per year, and (3) a 5% addition to surplus.

Because cooperatives, by definition, do not operate for profit, they would not have a taxable net income if subject to tax. Thus, the exemption has no fiscal effect. Distributions made by cooperatives to the cooperative members may be taxable, depending on the nature of the distribution (see the discussion of patronage dividends under the section on "Deductions from Gross Income").

### **Credit Unions**

Federally-chartered credit unions are exempt from state taxation under federal law. Wisconsin exempts state-chartered credit unions from taxation, except for the portion of their net income attributable to public deposits from the state or local governments. There are approximately 300 credit unions operating in Wisconsin; most of them are state chartered.

The estimate does not take into account the fact that, if credit unions did lose their exempt status, they would most likely receive much of the same favorable tax treatment accorded other financial institutions.

### **Insurance Companies**

The following insurance companies are exempt from income taxation:

- Insurance companies exempted under sec. 501 (c)(15) of the Internal Revenue Code. This section exempts companies other than life insurance companies whose net written premiums (or, if higher, their direct written premiums) do not exceed \$350,000.
- Town mutual companies organized under Chapter 612 of the Wisconsin Statutes.
- Foreign insurance companies, that is, any insurance company organized outside the state of Wisconsin.
- Domestic life insurance companies engaged exclusively in life insurance.
- Domestic insurance companies insuring against losses relating to mortgages.

In general, only domestic insurers pay the corporate franchise tax to the Department of Revenue, based on the portion of their net income attributable to lines of insurance other than life insurance. There are between 100 to 150 insurance companies subject to the franchise tax. Other insurance companies pay a premium tax (\$134.6 million in collections in FY06) to the Office of the Commissioner of Insurance, based on the amount of premiums written in Wisconsin. According to the 2005 annual report of the Office of the Commissioner of Insurance, as of December 31, 2005, there were 2,011 insurance companies with operations in the state, of which 377 were domestic companies. Of the domestic companies, 71 were town mutual companies. The fiscal effect of this exemption is unknown since it is not clear how income subject to tax would be defined.

### **Banks under Liquidation**

Banks placed in the hands of the Division of Banking, Wisconsin Department of Financial Institutions, for liquidation under sec. 220.08, Wis. Stats., are exempt from tax if such taxation would diminish the financial assets needed to make full payment to depositors. There have been relatively few bank liquidations in Wisconsin since the Depression in the 1930s. It is unlikely that this pattern will change. If it did, very little tax revenue could be expected from financial institutions undergoing liquidation.

### **Assets Distributed to the Menominee Indian Tribe**

Assets distributed by the U.S. government to members of the Menominee Indian Tribe or any corporations or organizations created by the tribe are exempt from state taxation. In addition, stocks, bonds, and other securities issued by tribal corporations or organizations are exempt from state tax.

Under federal law, states generally do not have the authority to tax business activities of Indian tribes provided that the activities are conducted on reservation property or property held in tribal trust.

### **Activities of Out-of-State Publishers and Certain Foreign Corporations**

Under federal law, the state has jurisdiction to tax the Wisconsin-apportioned share of the net income of an out-of-state corporation only if the corporation has nexus – that is, a business presence – in Wisconsin. A corporation generally has nexus in Wisconsin if it has property or employees (i.e., payroll) in the state on a regular basis. Certain exceptions to the nexus rules exist so that some out-of-state corporations will not be subject to the Wisconsin income and franchise tax.

Wisconsin allows the following exemptions from nexus:

- The storage of property with a firm in this state for purposes of fabricating, processing, manufacturing or printing the property for an out-of-state corporation.
- The storage of property on the premises of a Wisconsin firm when the intent is to distribute the goods outside the state.
- The printing, storage, and distribution of books, magazines, and other publications for out-of-state publishing companies that contract with Wisconsin printing firms.
- The storage of property in Wisconsin for no more than 90 days by foreign corporations, provided the property is stored at a site not owned by the foreign corporation and is transferred and used in the state for fabricating, processing, manufacturing or printing on the site where the property is stored. Further, the assessed property value of the site where the property is stored and transferred must be at least \$10 million but not more than \$11 million on January 1, 1999.

These out-of-state corporations usually have no payroll or plant and equipment in Wisconsin. Thus, the act of storing property in the state for processing, printing or other temporary purposes would have been the only factor establishing nexus, and in turn, a Wisconsin tax liability for the corporations, in the absence of these exemptions.

### **EXCLUSIONS FROM INCOME**

An exclusion is an item that is not included in the definition of gross income. Excluded income normally does not have to be reported on the tax return.

#### **Life Insurance Proceeds**

Amounts received by a corporation from an insurance company or any other insurer as payment for a death claim are exempt from income taxation. For example, if a company took out policies on the lives of its board members and was paid the value of insurance on the life of one of the board members upon his or her death, the insurance benefit would not be included in the income of the corporation subject to tax. However, the company could not claim a business expense deduction for the premiums it paid on the policy.

Companies are believed to represent a small proportion of all beneficiaries. Further, because insurance compensation is usually paid on the deaths of individuals past retirement age, the effect of this provision is thought to be small.

## Exchanges of Corporate Property or Stock

In general, a gain is recognized as a result of an exchange or disposition of property to the extent that any cash proceeds plus the taxpayer's basis in new property exceed the taxpayer's basis in the old property. However, gains from the following types of transactions are excluded from gross income:

- Exchange of property held for productive use in a trade or business or held for investment for like-kind (i.e., similar) property. Examples of like-kind exchanges are an exchange of a delivery truck for a delivery van, and an exchange of one real property for another real property. The nonrecognition of gain does not apply to exchanges involving inventory and intangible investments, such as stocks and bonds, or to any exchanged property disposed of within two years by either party, with exceptions for death or involuntary conversions.
- Exchange of stock in the corporation for property. For example, a shareholder might contribute property to a corporation for additional shares of stock.
- Involuntary conversions. There is no recognition of gain from involuntary conversions of property provided that the property is converted into similar property or if it is converted into money used to acquire similar property.
- Exchange of common or preferred stock in a corporation for similar stock in the same corporation. For example, a shareholder might be allowed to convert 100 shares of old stock into 200 shares of new stock.
- Certain exchanges of United States obligations. There is generally no recognition of gain if United States obligations must be surrendered in exchange solely for other United States obligations.
- Certain reacquisitions of real property. There is generally no recognition of gain if the seller of real property reacquires a real property in exchange for satisfaction of indebtedness secured by the real property.

The fiscal effects of these exemption devices generally are small because they represent a postponement of income that will eventually be taxed. In general, the taxpayer's basis in the new property is equal to the basis in the old property or otherwise reduced to take into account the fact that the property was acquired in a tax-free transaction.

## Recovery of Bad Debts, Prior Taxes and Delinquency Amounts

Receipts generated by the recovery of bad debts, prior taxes or delinquency amounts are excluded from gross income to the extent that they did not reduce income tax liability when deducted in a prior year. The portion of a recovery amount that gave rise to a tax benefit in prior years is taxable.

## Natural Resource-Related Cost-Sharing Payments

Payments received by corporations primarily for the purpose of conserving soil and water resources, protecting or preserving the environment, improving forests, or providing a habitat for wildlife may be excluded from gross income.

## SPECIAL TREATMENT

Certain corporate entities are subject to tax provisions that are substantially different from those provided for most corporations. While these entities pay corporate franchise or income taxes, the method used to compute the tax liability is different from that afforded other corporate taxpayers.

## Limit on Tax Liability of Insurers

The tax liability of insurance companies subject to the state income/franchise tax (see the discussion under the section on "Exemptions") is limited to 2% of the gross premiums derived from non-life lines of insurance in Wisconsin.

## Urban Mass Transportation Companies

Any corporation deriving 50% or more of its gross income from urban mass transportation is assessed a special tax of one-half of taxable income. Before the imposition of this tax, an amount equivalent to 8% of the depreciated cost of property used or useful in business, as well as federal income tax payments, are deductible;

interest paid is not. No revenue has been collected under this special tax levy since 1974.

There are approximately 23 county or municipality-owned urban mass transportation companies in Wisconsin, with the vast majority of revenues coming from operations in Milwaukee, Madison, Racine, Eau Claire, and Green Bay. Because each of these companies generally register losses or no net income, this exemption has no fiscal effect.

### **RICs, REITs and REMICs**

Certain types of corporations are substantially or fully exempt from tax at the corporate level provided that they meet certain percentage requirements for distributions to shareholders. These corporations are generally organized as investment vehicles and do not carry on a trade or business other than the investment activities.

A regulated investment company (RIC) must derive its income primarily from interest, dividends, and gains from the disposition of stock and securities. Most mutual funds are organized as RICs. At least 90% of a RIC's income must be distributed to its shareholders each year. If so, the corporation is allowed a deduction for the distributions to shareholders. This deduction reduces the corporation's net taxable income to a minimal amount and effectively eliminates any corporate tax liability. Failure to meet the distribution requirements results in the denial of the deduction and a substantial corporate tax liability.

A real estate investment trust (REIT) specializes in real estate investments and must derive its income primarily from rents from real property, other real property income, interest, dividends, and gains from the disposition of stock and securities. At least 90% of a REIT's income must be distributed to its shareholders each year. The taxation of REITs is essentially the same as the taxation of RICs in that a deduction for distributions to shareholders is allowed if the corporation meets the distribution requirement.

A real estate mortgage investment conduit (REMIC) is an entity that holds a fixed pool of mortgages and issues multiple classes of ownership interests to investors. In general, a REMIC is treated in a manner similar to a partnership. Thus, the net income of a REMIC is taxable to the holders of the interests in the REMIC.

There are relatively few of these types of investment corporations operating in Wisconsin. In addition, any income not taxed to the corporation is generally taxed to the shareholders. Thus, the fiscal effect of this exemption device is minimal.

### **Apportionment of Income**

Wisconsin requires multi-jurisdictional corporations to compute the amount of income taxable in this state through the use of a three-factor apportionment formula. The factors in the formula are based on the relationship of a company's property, payroll, and sales in Wisconsin to the total property, payroll, and sales in all jurisdictions. Each factor represents a ratio that is assigned a weight and then combined to yield a single income apportionment percentage.

Since 1974, Wisconsin has used an apportionment formula that double weights the sales factor. As such, the sales factor has a weight of 50% in the formula and each of the payroll and property factors are weighted at 25%. Double-weighting of the sales factor favors corporations with sales on a regional or national basis that have significant property and payroll in state.

Beginning in 2006, single sales factor apportionment will be phased in. For taxable year 2006, the apportionment formula will be composed of a sales factor representing 60% of the fraction, a property factor representing 20% of the fraction, and a payroll factor representing 20% of the fraction. For taxable year 2007, the apportionment formula will be composed of a sales factor representing 80% of the fraction, a property factor representing 10% of the fraction, and a payroll factor representing 10% of the fraction. The single sales factor formula will be fully phased in for taxable years beginning in 2008. Special apportionment formulas will continue to apply to certain industries, such as interstate trucking and financial institutions. This report does not incorporate the effect of single sales factor apportionment.

The fiscal effect of this exemption device is the difference in tax with greater weight being given to the sales factor as compared to a formula that weights each factor equally. Since the most recent data available relate to tax year 2003, the fiscal effect is the difference in the tax liability under a double-weighted factor and a formula that weights all factors equally. The revenue loss from tax savings to the corporations that benefit from double-



weighting the sales factor is offset somewhat by revenue gains from the increased taxes paid by corporations that would have had lower tax liabilities if the sales factor was single-weighted.

### **"Throwback" Sales**

A multi-state corporation subject to tax in Wisconsin is required to treat certain "throwback" sales as Wisconsin sales when calculating its sales factor using the multi-state apportionment formula. Throwback sales are sales originating in Wisconsin made to the federal government and shipped outside of Wisconsin and sales originating in Wisconsin to customers located in states where the seller is not subject to tax because of the nexus standards defined by federal law and interpreted by the Wisconsin Administrative Code.

Under the nexus standards, a corporation must have some type of operations in a state, generally in the form of property or employees, before its income can be taxed by that state. Without nexus, a state cannot tax a corporation. The throwback rule ensures that a corporation's entire income is subject to apportionment by the states with jurisdiction to tax. Without the throwback rule, sales to destination states in which the seller does not have nexus would not be included in the numerator of the sales factor of any state and a corporation would be able to avoid paying tax on some of its income.

One half of throwback sales shipped from Wisconsin are included in the numerator of the sales factor, while the full amount of throwback sales is included in the denominator. In other words, the sales factor weights throwback sales at one half the weight of in-state sales. This treatment will not change under the single sales factor apportionment formula that begins in 2008.

The estimate is based on the difference of half-weighting the throwback sales compared to the weights applied to in-state sales under the apportionment formula in effect in tax year 2003, the most recent data available.

### **Tax-Option Corporations**

A tax-option corporation is a corporation with not more than 75 individual shareholders that elects Subchapter S treatment under sec. 1362 of the Internal Revenue Code. Under Subchapter S, the corporation is exempt from tax at the corporate level and the net income is taxed to the individual shareholders under the individual income tax on a pro rata basis. The net income is taxed to the shareholders regardless of whether the corporation makes any actual distributions to the shareholders. In general, Subchapter S corporations are treated in a manner similar to partnerships and items of income retain their character as they flow through to the shareholders.

Most federal Subchapter S corporations are automatically treated as tax-option corporations for state purposes. However, Subchapter S corporations can elect to be treated as regular corporations for state purposes under certain conditions. Regular corporations converting to Subchapter S or tax-option treatment are subject to a special tax on built-in gains for both federal and state purposes.

### **Limited Liability Companies**

Limited liability companies (LLCs) are a type of business entity that may be taxed similar to corporations or partnerships, depending on how they are structured. If taxable as a partnership, owners of an LLC (called members) are taxed on the flow-through income of the company at lower individual rates, rather than at the higher corporate rate. However, if taxable as a corporation, an LLC is taxed at the entity level using the corporate income tax rate.

### **Unincorporated Cooperative Associations (UCA)**

2005 Act 441 authorized the creation of a new type of business organization called an unincorporated cooperative association (UCA). A UCA may be organized to market or process agricultural products; to manufacture products; to provide products, supplies or services; or for any other lawful purpose. A UCA may be organized by one or more organizers or it may be organized by converting from another form of business entity. The tax treatment of a UCA is similar to that of other pass-through entities, in that profits or losses are passed through to the UCA's members. Income and losses would be included on the owner's tax return and taxed at the owner's rate.

## DEDUCTIONS FROM GROSS INCOME

A deduction is an amount subtracted from Wisconsin gross income (or total income) to establish Wisconsin taxable income – the amount to which the tax rate is applied.

### Deductions Which Further Define Net Income

Sec. 71.23, Wis. Stats., subjects corporations to a tax on or measured by their net income. Net income is defined as gross income less allowable deductions. Thus, the very nature of the corporate tax requires that income be reduced by certain current expenses and allocated costs. These expenses include: wages and salaries, taxes, repairs, rents, interest, and the cost of employee benefits. These expenses are generally legitimate business outlays and thus are not considered a tax exemption device.

### Amortization and Other Special Cost Recovery Allowances

The cost associated with the consumption of an asset can be recovered in several ways. When an asset has a fixed life, costs are generally recovered through depreciation which is discussed later in this section. For assets with indeterminate lives, the cost recovery methods include amortization, depletion, and special cost recovery allowances. In addition, special cost recovery provisions apply for other types of costs that otherwise would not be recovered until the asset is disposed of, income is received for the product or service for which the cost was incurred or the corporation is dissolved. The following costs are eligible for recovery techniques that allow taxpayers to recover costs sooner than would otherwise be allowed.

1. Pollution control facilities. The cost of certain pollution control facilities can be amortized over a period of five years. To qualify, the pollution control facility must be used in connection with a plant in operation prior to 1976.
2. Circulation expenditures. Costs (other than costs to acquire land, depreciable property, and part of the business of other newspapers or periodicals) to establish, maintain or increase the circulation of newspapers and periodicals can be deducted in the year paid.
3. Research and development expenditures. Costs of noncapital research and experimental activities can be deducted in the year paid or amortized over a period of five years (see also the discussion of noncapital expenditures under the Research Expenditures Credit in the section on "Credits").
4. Soil and water conservation expenditures. Taxpayers engaged in farming can deduct, in the year paid, the costs of soil and water conservation practices that are consistent with a conservation plan approved by the Soil Conservation Service of the U.S. Department of Agriculture. The deduction cannot exceed 25% of gross income from farming.
5. Lease acquisition. The cost of acquiring a lease, including renewal options, can be deducted in the year paid if certain requirements are met.
6. Fertilizer expenditures. Taxpayers engaged in farming can deduct the cost of fertilizers, lime, and other materials used to condition land utilized in farming in the year paid.
7. Disabled access expenditures. Up to \$15,000 of costs to remove architectural and transportation barriers to the disabled and elderly can be deducted in the year paid.
8. Tertiary injectants. Costs of tertiary injectants, used as part of tertiary recovery methods for oil and gas, can be deducted in the year paid.
9. Reforestation expenditures. Up to \$10,000 of costs to reforest qualified timber property can be amortized over a period of seven years.
10. Start-up expenditures. Costs of incorporating the taxpayer's business and issuing stock for the business can be amortized over a period of five years.

11. Intangible drilling costs. Operators of a domestic oil, gas or geothermal well may elect to expense intangible drilling and development costs, rather than capitalizing the costs through depletion or depreciation. For operators of wells located outside the U.S., costs can be recovered over a 10-year, straight-line amortization schedule or added to the adjusted basis of the property for cost depletion, at the choice of the taxpayer.
12. Mine exploration and development. A portion of the costs of exploring for energy and mineral deposits and developing such deposits for mining or drilling can be deducted in the year paid. The remaining portion is amortized over a period of five years.

Depletion allowances are provided to allow taxpayers to recover the costs of capital investment in natural resources. Under the cost depletion method, the acquisition costs are divided by the estimated number of units that the deposit or resource will produce. Taxpayers are allowed an annual deduction equal to the current year's production multiplied by the per unit depletion cost. Federal law also allows taxpayers the option of using percentage depletion, which provides taxpayers with an annual deduction equal to a percentage of the gross income from the current year's production.

For state purposes, only cost depletion is allowed. Since cost depletion does not allow for rapid cost recovery in the way that percentage depletion does, cost depletion is not considered an exemption device.

The special expensing provision for depreciable property under sec. 179 of the Internal Revenue Code is discussed under Depreciation in this section.

### **Charitable Contributions**

Contributions by corporations to the following charities are deductible from gross income:

- The state or any other political subdivision, as long as the gift is for strictly public purposes.
- A corporation, trust or community chest, fund or foundation operating for strictly religious, charitable, scientific, literary or educational purposes, or for fostering national or international sports competition, or for the prevention of cruelty to children or animals.
- Veterans' organizations and an auxiliary unit, society, trust or foundation of such organizations.
- Member-owned or nonprofit cemetery corporations chartered solely for burial purposes.

Certain limitations apply to the amount of contributions that can be claimed as a deduction and to the amount that can be deducted for contributions of property. In general, the deduction for charitable contributions cannot exceed 10% of a corporation's taxable income. Amounts of contributions not deductible in the current year can be carried forward for five years and claimed as a deduction.

### **Depreciation – Modified Accelerated Cost Recovery Systems and Expensing Election**

Depreciation deductions are allowed to reflect the reasonable expenses incurred by taxpayers for exhaustion, wear and tear of property used in a trade or business or held for the production of income. Effective for tax year 1987, the state adopted the Modified Accelerated Cost Recovery System (MACRS), enacted as part of the federal Tax Reform Act of 1986. However, property placed in service prior to that time must continue to be depreciated according to the state restrictions in effect at the time the property was placed into service.

Under MACRS, eligible property is generally assigned to a depreciation recovery class of 3 years, 5 years, 7 years, 10 years, 15 years or 20 years, 25 years, 27.5 years, 31.5 years or 39 years, depending upon the type of property. The cost of the property is recovered using statutory recovery methods and conventions.

With some restrictions, sec. 179 rules of the Internal Revenue Code in effect prior to December 31, 2000, allow taxpayers to expense up to \$25,000 in the current year. To qualify as sec. 179 property, the property must be acquired by purchase for use in the active conduct of a trade or business (sec. 1245 depreciable property). The total cost of the property expensed under this election cannot exceed the total amount of taxable income derived from the active conduct of any trade or business during the tax year. However, excess amounts may be carried forward an unlimited number of years, subject to the ceiling each year.

Wisconsin has not adopted the increased bonus depreciation and expensing provisions enacted after December 31, 2000.

The fiscal effect of the accelerated depreciation exemption device relates to the revenue impact of allowing more generous depreciation write-offs in comparison to the allowable deductions under the straight-line depreciation method.

### **Dividends**

Dividends paid are generally not deductible by the payor corporation except for:

- Amounts paid as dividends or earnings to depositors' accounts by savings and loan associations, mutual loan corporations or mutual savings banks.
- Amounts distributed to patrons of businesses operating on a cooperative basis in proportion to their patronage, rather than stock or ownership. This type of dividend amounts to a delayed discount for purchases made.

Dividends received are deductible in full by the recipient corporation if the payor corporation is a controlled subsidiary in which the recipient parent corporation owns at least 70% of the voting stock. The payor corporation is not allowed to subtract the dividends paid in determining its Wisconsin taxable income.

### **Bad Debt Reserves of Financial Institutions**

In general, corporations can deduct bad debts only as the debts become worthless. Savings and loan associations, mutual savings banks, and other savings institutions may deduct additions to a reserve account for bad debts in lieu of deducting bad debts as they are experienced. Banks are also allowed to deduct additions to bad debt reserves, provided that the assets of the bank do not exceed \$500 million.

The deduction for additions to bad debt reserves is generally based on the average ratio of bad debts actually incurred to total loans outstanding for the five preceding taxable years. The tax benefit from this provision is that financial institutions using the reserve method can deduct bad debts before they actually become worthless.

### **Net Operating Loss Carryforward**

Wisconsin authorizes corporations to carry net operating losses incurred in the current year forward for up to 15 years to offset net income in future years but does not allow losses to be carried back to offset taxable net income in previous years. In contrast, Federal law allows losses to be carried forward 20 years or carried back two years. This treatment acts to smooth out fluctuations in corporate profits, which may change dramatically with economic conditions. Similar to federal law, prior year losses must be applied against income to the maximum extent possible and in a consecutive fashion during the carryover period. Losses from the earliest years are always used first. The fiscal effect relates to the difference in tax liability without the carryforward provision relative to actual liability under current law.

### **Qualified Production Activities Deduction**

Until 2000, federal law exempted a portion of the foreign trade income of a foreign sales corporation (FSC) from federal tax, provided that the income was derived from the foreign presence and business activity of the FSC. Following several rulings by the World Trade Organization (WTO) that the FSC provisions created an unfair trade advantage to these companies, the FSC exemption was ultimately repealed and replaced in the 2004 federal American Jobs Creation Act with a deduction for Qualified Production Activities Income (QPAI) for manufacturers to replace the existing tax exemption. Wisconsin has adopted the QPAI provisions of this new federal law. When the deduction is fully phased in (in 2010) it will equal 9% of the lesser of: (a) qualified production activities income for the year or (b) taxable income for the year. The new deduction will be phased in over a number of years with a deduction transition percentage of 3% for 2005 and 2006, and 6% for 2007 through 2009. While the QPAI deduction is intended to offset the loss of tax benefits due to the repeal of the prior exclusion, it appears that the QPAI deduction will not benefit the same firms as the prior exemption.

## CREDITS

A credit is an amount subtracted directly from the taxpayer's Wisconsin gross tax liability (i.e., the amount determined by applying the Wisconsin tax rate to Wisconsin taxable income) to determine the Wisconsin net tax liability. Generally, corporate tax credits are nonrefundable, that is, used only to reduce the amount of tax otherwise due.

### Credit for Sales Tax on Fuel and Electricity Used in Manufacturing

Until 2006, a nonrefundable credit could be claimed for the amount of Wisconsin sales tax paid on fuel and electricity consumed in manufacturing tangible personal property in the state. The credit was designed to be the equivalent of a sales tax exemption. Unused amounts of credit could be carried forward and offset against tax liability over the next 20 years. Corporations were required to increase their net income by the amount of credit claimed in lieu of reducing their deduction for the sales tax portion of the expense of fuel and electricity.

Beginning in 2006, fuel and electricity used in manufacturing are exempt from the sales tax and the credit for sales tax is repealed. Manufacturers that meet certain conditions may continue to use manufacturers' sales tax credit carried forward from prior years to offset income in the future. Manufacturers with up to \$25,000 of unused credit may take up to 50% in 2007 and 2008. Manufacturers with more than \$25,000 of unused credit will be allowed to deduct unused credits over the next two years and will be eligible for the manufacturing investment credit, discussed below.

### Manufacturing Investment Credit

Beginning in 2008, businesses whose credit for sales tax on fuel and electricity used in manufacturing was disallowed after repeal of that credit in 2006 will be able to claim a manufacturing investment credit, provided they meet certain job retention, investment or other tests. The credit will equal the unused manufacturers' sales tax credit that was disallowed, amortized over 15 years, with a 15-year carryforward of unused credits. Claimants must satisfy one of the following:

- Retention of 100% of the full-time (at least 35 hours per week) jobs employed by the company as of December 23, 2003.
- Average annual investment since January 1, 2003, equal to 2% of total book value of the company's depreciable assets in Wisconsin-based plants and facilities or \$5 million.
- Other criteria specific to individual industries as determined by the Department of Commerce, in consultation with the Department of Revenue, through administrative rule.

### Research Expenditures Credit

A nonrefundable research expenditures' credit for noncapital expenditures for research-related activities conducted in Wisconsin is available to corporations. The credit is patterned after the federal research credit and is equal to 5% of the excess of qualified research expenses for the current year over a base period amount. Qualifying expenditures are defined by reference to the rules established under sec. 41 of the Internal Revenue Code. Expenses must be incurred in connection with research conducted in Wisconsin in order to qualify for the credit. The "base period amount" is calculated in the same manner as that for the federal credit, except that the gross receipts used in computing the state credit are from sales attributable to Wisconsin, other than throwback sales, as defined in the corresponding statute. Unused amounts of the credit can be carried forward for up to 15 years.

The credit applies only to research expenditures that are undertaken to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. Qualified research expenses cover in-house expenses for the taxpayer's own research (wages, supplies, and computer use charges) and 65% of amounts paid or incurred for qualified research done by a person other than an employee of the taxpayer.

For tax years beginning after December 31, 2007, the research expenditures credit is expanded to include a credit equal to 10% of qualified research expenses related to designing internal combustion engines and related substitutes such as fuel cells and electric and hybrid drives. The credit is also available for research related to

designing vehicles powered by such engines and for research on improving production processes for such engines and vehicles.

### Research Facilities Credit

The research facilities credit applies to capital investments to construct and equip new research facilities or to expand existing facilities located in Wisconsin. The credit is equal to 5% of the amount of qualified investment in tangible depreciable property that is not replacement property.

The rules relating to the credit are similar to the rules for the research expenditures credit. The credit is nonrefundable, and unused amounts of credit may be carried forward and offset against tax liability over the next 15 years. Corporations must increase their net income by the amount of credit claimed in lieu of reducing their deduction for research expenses or reducing their basis in the property.

### Supplement to Federal Historic Rehabilitation Credit

A nonrefundable credit is available to encourage the rehabilitation of historic buildings in Wisconsin. The state supplemental credit is equal to 5% of qualified rehabilitation expenditures, as defined under sec. 48 (g) of the Internal Revenue Code, to substantially rehabilitate certified historic buildings for use in a trade or business. This program is more fully discussed in the chapter on "Individual Income Tax."

### Development Zone, Airport Development Zone, Development Opportunity Zone, Enterprise Zone Jobs Credit, Enterprise Development Zone, and Agricultural Development Zone Credits

Credits are available to corporate taxpayers who are certified by the Department of Commerce to participate in the Wisconsin development zone, airport development zone, development opportunity zone, enterprise zone, enterprise development zone, and agricultural development zone programs.

The *development zone program* provides credits to taxpayers that locate or expand a trade or business activity within a development zone. A development zone is an economically distressed area designated as a development zone by the Wisconsin Department of Commerce. The Department is authorized to designate 22 zones. All 22 zones have been designated, with authorized tax credits of \$38.155 million. These zone designations are in effect for a period of seven to ten years. Certified businesses are provided with a maximum amount of tax benefits and may claim the development zone credits up to that amount.

The Department of Commerce was authorized by 2005 Act 487 to designate an area as an *airport development zone* if certain criteria are met. An airport development zone may not be in an area that is a development zone, a development opportunity zone or an enterprise zone. The designation is effective for 84 months. Total income and franchise tax credits for each zone may not exceed \$3 million, and total tax benefits for all zones may not exceed \$9 million.

Under the *development opportunity zone* program, corporations, except insurance companies, conducting economic activities in this type of zone may claim tax credits allocated to them. These zones have a duration of three years. Six zones with \$29.4 million in tax credits have been authorized. Four of the six zones created have expired. Corporations locating or expanding their operations within the development opportunity zones are also eligible to claim an investment credit that equals 2.5% of the purchase of depreciable tangible personal property (or 1.75% of the price if the property has been expensed under sec. 179 of the Internal Revenue Code).

A *capital investment credit* is available for certain businesses located in the Beloit and Milwaukee development opportunity zones and, beginning in 2006, to businesses in airport development zones equal to 3% of qualified purchases of depreciable tangible personal property and amounts expended to acquire, construct, rehabilitate or remodel qualified real property.

For tax years beginning on or after July 1, 2007, a refundable *enterprise zone jobs credit* against income and franchise taxes for certified business located in an enterprise zone is available. The credit has three components: (1) a payroll component based on changes in the claimant's payroll over a base year; (2) a component available only to claimants whose entire property and payroll is in the enterprise zone, which is based on the sum of the claimant's payroll and basis of property; and (3) a component based on the amount a claimant pays for training to upgrade the skills of full-time employees who work in the enterprise zone.

The Department of Commerce is authorized to designate no more than 10 enterprise zones and may not designate an area as an enterprise zone if the area exceeds 50 acres. A designation may be in effect for no

more than 12 years. In determining whether to designate an area as an enterprise zone, the Department of Commerce must consider indicators of the area's economic need, infrastructure and energy support, the rate of business development, existing resources available to the area, and the effect of designation on other initiatives and programs to promote economic and community development in the area, such as job training and the creation of high-paying jobs.

*Enterprise development zones* are areas in which businesses are permitted to operate and receive tax credits. A business planning to conduct economic activity in a specific area of the state can apply with the Department of Commerce to have the area designated as an enterprise development zone. Designation for a period of seven years is based on criteria relating to high unemployment and poverty, declining property values and declining population. The Department of Commerce has authority to designate up to 98 enterprise development zones; at least 10 of the zones must be for environmental remediation. Each zone is allocated a maximum of \$3 million credits, so that total credits under the program may total as much as \$294 million. Sixty-one enterprise development zones have been authorized with \$146 million of credit allocated. Of the 61 zones designated, 32 have reached the 7-year expiration date.

Beginning in 2003, the Department of Commerce may certify one zone as an *agricultural development zone*. The area must be located in a rural municipality and the zone designation will be in effect for ten years. The area may be certified for up to \$5 million of credits. Four regions, made up of 18 counties, were designated as the agricultural development zone.

For all of these zones, the credit for creation or retention of full-time jobs and for environmental remediation in a zone is comprised of the following components:

- Up to \$8,000 for each full-time job created or retained by a member of a target group;
- Up to \$6,000 for each full-time job created or retained and filled by a person who is not a member of a target group; and
- Up to 50% of amounts spent for environmental remediation.

A member of a target group includes a person employed in unsubsidized or trial jobs under the Wisconsin Works program, a person qualifying for the Wisconsin Works health plan or child assistance, a vocational rehabilitation referral, an economically disadvantaged veteran, an economically disadvantaged ex-convict, a social security insurance recipient, a food stamp recipient or a dislocated worker.

### **Dairy and Livestock Farm Investment Credit**

A nonrefundable credit is available for 10% of expenses to modernize or expand a dairy or livestock farm. Dairy animals include heifers raised as replacement dairy animals. Livestock includes cattle (not including dairy animals), swine, poultry including farm raised pheasants but not including other farm raised game birds or ratites, fish that are raised in aquaculture facilities, sheep, and goats. The aggregate amount of credit that a taxpayer could claim is \$50,000 for expenses to construct, improve and acquire buildings or facilities and equipment, for dairy animal housing, confinement, feeding, milk production, and waste management. The credit may be claimed for taxable years that begin after December 31, 2003, and before January 1, 2010.

### **Technology Zone Credit**

A credit is available for businesses certified by the Department of Commerce and located in a technology zone. The Department of Commerce may certify up to eight technology zones, each for up to \$5 million in credits. All eight zones have been designated. Sixteen businesses have been certified for \$2.5 million.

The credit has the following components:

- The amount of real and personal property taxes imposed and paid in the taxable year;
- 15% of the first 12 months of wages for jobs created in a technology zone after certification; and
- 10% of certain capital investments made in a technology zone in the year.

### **Early Stage Seed Investment Credit**

Effective for taxable years beginning after 2004, an early stage seed investment credit is available for 25% of investments in qualified new business ventures that are certified by the Department of Commerce. To be eligible for credit, a qualified new business venture must meet certain requirements, including that it have its headquarters in the state, have less than 100 employees, at least 51% of whom are employed in the state, and have been in business for not more than seven consecutive years. A qualified new business venture must also be engaged in certain industries: manufacturing, agriculture, processing or assembling products, conducting research and development or developing new products or business processes. The total amount of credits that may be claimed is \$3.5 million per taxable year and \$35 million for all taxable years.

### **Farmland Tax Relief Credit**

A farmland tax relief credit equal to a percentage, established by the Department of Revenue, of property taxes accrued on farmland, exclusive of improvements, is allowed for owners of farmland. The maximum credit is \$1,500, and the credit is refundable. The credit percentage is set so that the amount expended for the credit for all claimants, individual and corporate, is \$15 million, adjusted for underspending or excess spending in the prior fiscal year. For tax year 2005, the percentage was 20%. The fiscal estimate in this section represents claims by corporate taxpayers. The credit is described in greater detail in the Individual Income Tax chapter.

### **Farmland Preservation Credit**

Corporations are eligible for Farmland Preservation Credits and must meet basically the same requirements as individual taxpayers (see Individual Income Tax chapter). Household income for corporations is defined as the sum of net corporate income, any business loss carryforward allowed under sec. 71.26 (4), Wis. Stats., and the household income of each corporate shareholder including the income of spouse, dependents, and other members of the household. Corporations must include in their household income farm depreciation in excess of \$25,000, all nonfarm depreciation, and nonfarm business losses. The credit is refundable.

### **Community Development Finance Credit**

Corporations that make contributions to the Wisconsin Housing and Economic Development Authority (WHEDA) and, in the same year, purchase common stock in the Community Development Finance Company may claim a credit. The credit is equal to 75% of the cost of common stock or a partnership interest purchased in the Community Development Finance Company. The base for computing the credit is limited to the value of the claimant's contribution to WHEDA. The credit is nonrefundable and unused amounts of credit can be carried forward and offset against tax liability over the next 15 years. Taxpayers must increase their income by the amount of the credit claimed in lieu of reducing their deduction for the contribution to WHEDA.

### **Insurance Security Fund Assessments**

Chapter 646, Wisconsin Statutes, provides a credit against state taxes, including the corporate income and franchise tax, for certain assessments levied on insurance companies by the Wisconsin Insurance Security Fund. The fund is designed to protect policyholders in cases where their insurance company has failed and is in the process of liquidation. Where the available assets and reserves of failed insurers are inadequate to meet claims, the fund may assess insurance companies doing business in the state, with some exceptions (e.g., fraternal benefit societies). Such assessments are eligible for a 100% tax credit if they cannot be recovered through higher premiums. This can occur if premiums are fixed for a particular line of business. Credits claimed by foreign insurance companies and domestic life companies would be offset against the premiums tax. Thus, the only offsets against the income and franchise tax would be for credits claimed by domestic property and casualty companies. The tax credit is nonrefundable and must be claimed in equal installments over a five-year period, beginning with the year following the one in which the assessment is made.

### **Health Insurance Risk-Sharing Plan Assessments Credit**

An income and franchise tax credit and a license fee credit are available for insurers that pay assessments for the Health Insurance Risk-Sharing Plan (HIRSP). HIRSP offers health insurance coverage to individuals with adverse medical histories and to others who cannot obtain affordable health insurance coverage from the private sector. HIRSP is funded by premiums paid by participants, assessments paid by insurance companies, and a pro rata reduction in billed charges of health care providers. The amount of the credit for all insurers cannot exceed



\$5,000,000 per year. The credits apply to taxable years beginning after December 31, 2005, but the credits for the 2006 and 2007 tax years may not be claimed until taxable years beginning after December 31, 2007.

### **Film Production Credits**

For tax years beginning after December 31, 2007, several tax credits will be available for expenses related to film production activities for productions accredited by the Department of Commerce. The credits include:

- A film production services income and franchise tax credit. The credit is equal to 25% of salary or wages paid for services rendered in Wisconsin to produce an accredited production, and paid to employees who were residents of Wisconsin when they were paid. The credit for salary or wages paid must not exceed an amount equal to the first \$25,000 of salary or wages paid to each of the claimant's employees, not including the salary or wages paid to the claimant's two highest paid employees. The credit is also equal to 25% of production expenditures, as defined in the bill, paid by the claimant in the taxable year to produce an accredited production.
- A sales and use tax credit, for taxes that the claimant paid in the taxable year on the purchase of tangible personal property and taxable services that are used directly in an accredited production.
- A film production company investment credit. A claimant may claim a credit against income and franchise taxes, up to the amount of the taxes, for the first three taxable years that the claimant is doing business in Wisconsin as a film production company, an amount equal to 15% of the purchase price of depreciable, tangible personal property, and the amount expended to acquire, construct, rehabilitate, remodel or repair real property.

The portion of the credit applicable to production expenditures is refundable. The remainder of the credits may be carried forward for 15 years.

### **Broadband Internet Equipment Exemption and Credit**

The sales and use tax exemption and income tax credit created by 2005 Act 479 apply to the purchase of "Internet equipment used in the broadband market." This equipment is defined to be equipment that is capable of transmitting data packets or Internet signals at speeds of at least 200 kilobytes per second in either direction. For a purchaser of Internet equipment used in the broadband market to receive the sales and use tax exemption, the purchaser must certify to the Department of Commerce, that the purchaser will, by July 1, 2009, make an investment that is reasonably calculated to increase broadband Internet availability in Wisconsin and the Department of Commerce must certify the purchaser as eligible for the exemption. The purchases cannot take place before July 1, 2007, which is when the sales and use tax exemption takes effect.

For a purchaser of Internet equipment used in the broadband market to receive the income tax credit, the purchaser must have claimed the sales and use tax exemption described above and be certified by the Department of Commerce as eligible for the tax credit. The total amount of sales and use tax exemptions and income tax credits may not exceed \$7.5 million.

## RECYCLING SURCHARGE

### Introduction

Effective for tax years beginning on or after January 1, 2000, Wisconsin imposes a recycling surcharge on all non-farm businesses with gross receipts of at least \$4 million. The surcharge is imposed at a rate of 3% on gross tax liability for corporations and 0.2% of net business income for noncorporate business entities. The maximum surcharge is \$9,800 and the minimum is \$25. Noncorporate farms are exempt from the surcharge if their gross receipts from farming are no more than \$4,000,000; they pay a surcharge of \$25 if not exempt. The surcharge does not apply to entities not required to file an income tax return.

Revenues from the recycling surcharge are deposited in the segregated recycling fund and used to fund local government recycling and solid waste management programs and private business efforts to develop recycled products or markets related to these products. Collections for FY06 were \$19.5 million.

**TABLE 1  
RECYCLING SURCHARGE EXEMPTION DEVICES SUMMARY**

Exemption Devices	Statutory Reference*	FY06 Fiscal Effect
<b>Exemptions from Taxation</b>		
Exempt Corporations	s 77.93 (1)	Not available
Exempt Individuals, Estates, and Trusts	s 77.93 (2)	Not available
\$4 Million Gross Receipts Exemption	s 77.93 (1) and 77.94 (1)(b)	\$17,200,000
Members of the Clergy and Certain Religious Groups	s 77.92 (5)	Minimal
<b>Special Treatment</b>		
\$9,800 Surcharge Limit	s 77.94 (1)	\$9,700,000
Farming Surcharge of \$25	s 77.94 (1)	Minimal

\* References to sections of the 2005 Wisconsin Statutes.

### EXEMPTIONS FROM TAXATION

#### Exempt Corporations

Corporations that are exempt from the corporate income and franchise tax under sec. 71.26 (1), Wis. Stats., and that have no unrelated business income reportable under sec. 71.24 (1m), Wis. Stats., are exempt from the surcharge. This exemption applies to not-for-profit entities.

#### Exempt Individuals, Estates, and Trusts

Only persons who file a form indicating a profit or loss from a trade or business for federal income tax purposes are subject to the recycling surcharge. The surcharge does not apply to natural persons, estates or trusts that are not required to file a return because their income is less than the filing requirements under Subchapter I or II of Chapter 71, Wis. Stats. In addition, persons who are not employees as defined in section 3121 (d)(3) of the Internal Revenue Code are exempt from the surcharge.

#### \$4 Million Gross Receipts Exemption

Businesses with less than \$4 million of gross receipts are exempt from the surcharge.

#### Members of the Clergy and Certain Religious Groups

Members of the clergy and members of certain recognized religious groups who perform services or duties as defined by section 1402(c)(4) and (5) of the Internal Revenue Code are exempt from the temporary recycling surcharge.

**SPECIAL TREATMENT**

**\$9,800 Surcharge Limit**

The maximum surcharge that any taxpayer will pay is limited to \$9,800. This is considered an exemption device because the amount of surcharge that is collected is less than it would be had the surcharge been collected under the existing rates without the maximum.

**Farming Surcharge of \$25**

All natural persons, estates, trusts, partnerships, and limited liability companies that are engaged in farming, except entities that have gross receipts from farming of no more than \$4 million, are subject to a surcharge of \$25 regardless of the amount of net farm profit. It is believed that very few noncorporate farms have gross receipts of at least \$4 million and are subject to the surcharge.

## SALES AND USE TAX

### Introduction

Wisconsin imposes a 5% tax on the sale or use of most items of tangible personal property and on the sale of selected services. The state first imposed a 3% selective sales and use tax in 1962 but replaced it with a 4% general sales and use tax in 1969. The current 5% rate has been in effect since 1982.

The original 3% tax was selective in that goods subject to the tax were specifically identified in the statutes: household furnishings, motor vehicles, jewelry, tobacco, fermented malt beverages, intoxicating liquors, and food sold in restaurants were taxable. The general tax imposed in 1969, in contrast to the selective tax, falls on sales of all tangible personal property, except property specifically exempted by law. The sales tax remains selective in its treatment of services, imposed only on those services the law enumerates as taxable.

Numerous changes to the sales tax base have been made over the years. Exemptions are discussed in detail in the latter half of this chapter and estimates of fiscal effects are provided. Expansions of the sales and use tax base include:

- Cigarettes (1975);
- Cable television, including installation (1975);
- Interstate telephone and telegraph services, and landscaping and lawn maintenance services (1982);
- Magazines other than those sold by subscription (1983);
- Telephone company central office equipment and coin-operated telephone services (1996);
- Telephone answering and messaging services, and telecommunications services terminating in and billed to a service address in the state (1997).

The 5% sales tax is imposed on retailers for the privilege of selling, leasing or renting tangible personal property that is not specifically exempt from tax. In addition, a 5% use tax is imposed on the storage, use or other consumption in this state of tangible personal property that is purchased out-of-state and is not specifically exempt. The use tax complements the sales tax in that, without a use tax, consumers would be able to avoid sales tax by purchasing goods out-of-state. Thus, the use tax ensures that the sales tax does not place Wisconsin merchants at a competitive disadvantage compared with those in other states.

### Taxable Services

The law imposes a sales tax on selected services. Unlike tangible personal property, sales of which are taxable unless specifically exempt, services are not subject to the sales tax unless enumerated in the statutes. The following services are taxable:

- Rooms or lodging for less than one-month by hotelkeepers, motel operators, and other persons furnishing accommodations to the public.
- Admissions to amusement, athletic, entertainment or recreational events or places. Admissions to places or events that are educational in nature, such as museums or zoos, and admissions to county fairs are exempt from sales tax.
- Telecommunications services originating or terminating in Wisconsin and charged to a service address in the state, including coin-operated telephone services, and Internet access services. Prepaid telephone cards or authorization numbers are taxed at the time of purchase; services obtained through the use of cards or authorization numbers are not taxable.
- Laundry, dry cleaning, pressing, and dyeing services, except when performed on raw materials or goods in process destined for sales, when performed on cloth diapers by a diaper service, and when performed by the customer through the use of coin-operated, self-service machines.

- Photographic services, including the processing, printing, and enlarging of film, and the services of photographers for the taking, reproducing, and sale of photographs.
- Parking or providing parking space for motor vehicles and aircraft, and docking or providing storage space for boats.
- The repair, inspection, and maintenance of tangible personal property, and the installation of tangible personal property, except when such installation constitutes a capital improvement to real property.
- The production, printing or imprinting of tangible personal property for consumers who furnish directly or indirectly the materials used in such processes.
- Cable television services, including installation charges.
- Landscaping and lawn maintenance services.
- Telephone answering and messaging services.

### Local Taxes

The law allows counties and a professional football stadium districts to impose a 0.5% local sales and use tax and a professional baseball park district to impose a 0.1% sales and use tax. These local taxes are imposed on the same tax base as the state sales and use tax. As of July 1, 2006, 59 counties impose the 0.5% county sales and use tax.

The Southeast Wisconsin Professional Baseball Park District imposed a 0.1% sales tax in Milwaukee, Ozaukee, Racine, Washington, and Waukesha Counties in 1996. Proceeds from this tax are used to finance Miller Park, the Milwaukee Brewers' home field. This tax will be discontinued upon retirement of the bonds issued to finance the ballpark and the funding of a maintenance and capital improvement fund for the ballpark.

The Green Bay-Brown County Professional Football Stadium District imposed a 0.5% sales tax in Brown County in 2000 to finance the renovation of Lambeau Field. This tax will be discontinued upon retirement of the bonds issued to finance the stadium and the funding of a maintenance and capital improvement fund for the stadium.

Table 1 lists the state's 72 counties, the local sales taxes applicable in each county, the effective date of the county sales tax, and the combined state and local sales tax rate.

### Administration and Collections

Sales tax is imposed on the gross receipts from retail sales; use tax is imposed on the amount paid for a product that is subject to sales tax but for which the seller does not collect sales tax. Each retailer is responsible for paying sales tax, regardless of whether it is identified on the bill and collected directly from the customer. Every business that makes taxable sales is required to obtain a seller's permit from the department and pay a \$20 business tax registration fee, which covers permits for alcohol, cigarette, and other taxes.

Retailers are permitted to retain a portion of the taxes they collect as compensation for the costs they incur in collecting the tax. Since 1997 the retailer's discount has been 0.5% of the amount of tax liability if taxes are paid timely, with a minimum discount of \$10 per filing period. Retailers file monthly, quarterly or annually, depending on the amount of tax owed.

In contrast to the sales tax which is paid by the seller, use tax is paid by the purchaser. Corporations may file a use tax return or report use tax on their corporate income and franchise tax returns. Private individuals typically report their use tax liability on their individual income tax returns.

**TABLE 1  
LOCAL SALES AND USE TAXES AND COMBINED STATE-LOCAL TAX RATE BY COUNTY  
JULY 1, 2006**

County	Local Taxes (Effective Date)	Combined State-Local Tax Rate	County	Local Taxes (Effective Date)	Combined State-Local Tax Rate
Adams	County (1/1/94)	5.5%	Marathon	County (4/1/87)	5.5%
Ashland	County (4/1/88)	5.5%	Marinette	County (10/1/01)	5.5%
Barron	County (4/1/86)	5.5%	Marquette	County (4/1/89)	5.5%
Bayfield	County (4/1/91)	5.5%	Menominee	None	5.0%
Brown	Football (11/1/00)	5.5%	Milwaukee	County (4/1/91), Baseball (1/1/96)	5.6%
Buffalo	County (4/1/87)	5.5%	Monroe	County (4/1/90)	5.5%
Burnett	County (4/1/89)	5.5%	Oconto	County (7/1/94)	5.5%
Calumet	None	5.0%	Oneida	County (4/1/87)	5.5%
Chippewa	County (4/1/91)	5.5%	Outagamie	None	5.0%
Clark	None	5.0%	Ozaukee	County (4/1/91), Baseball (1/1/96)	5.6%
Columbia	County (4/1/89)	5.5%	Pepin	County (4/1/91)	5.5%
Crawford	County (4/1/91)	5.5%	Pierce	County (4/1/88)	5.5%
Dane	County (4/1/91)	5.5%	Polk	County (4/1/88)	5.5%
Dodge	County (4/1/94)	5.5%	Portage	County (4/1/89)	5.5%
Door	County (4/1/88)	5.5%	Price	County (1/1/93)	5.5%
Douglas	County (4/1/91)	5.5%	Racine	Baseball (1/1/96)	5.1%
Dunn	County (4/1/86)	5.5%	Richland	County (4/1/89)	5.5%
Eau Claire	County (1/1/99)	5.5%	Rock	None	5.0%
Florence	County (7/1/06)	5.5%	Rusk	County (4/1/87)	5.5%
Fond du Lac	None	5.0%	St. Croix	County (4/1/87)	5.5%
Forest	County (4/1/95)	5.5%	Sauk	County (4/1/92)	5.5%
Grant	County (4/1/02)	5.5%	Sawyer	County (4/1/87)	5.5%
Green	County (1/1/03)	5.5%	Shawano	County (4/1/90)	5.5%
Green Lake	County (7/1/99)	5.5%	Sheboygan	None	5.0%
Iowa	County (4/1/87)	5.5%	Taylor	County (7/1/99)	5.5%
Iron	County (4/1/91)	5.5%	Trempealeau	County (10/1/95)	5.5%
Jackson	County (4/1/87)	5.5%	Vernon	County (1/1/97)	5.5%
Jefferson	County (4/1/91)	5.5%	Vilas	County (4/1/88)	5.5%
Juneau	County (4/1/92)	5.5%	Walworth	County (4/1/87)	5.5%
Kenosha	County (4/1/91)	5.5%	Washburn	County (4/1/91)	5.5%
Kewaunee	None	5.0%	Washington	County (1/1/99), Baseball (1/1/96)	5.6%
La Crosse	County (4/1/90)	5.5%	Waukesha	Baseball (1/1/96)	5.1%
Lafayette	County (4/1/01)	5.5%	Waupaca	County (4/1/89)	5.5%
Langlade	County (4/1/88)	5.5%	Waushara	County (4/1/90)	5.5%
Lincoln	County (4/1/87)	5.5%	Winnebago	None	5.0%
Manitowoc	None	5.0%	Wood	County (1/1/04)	5.5%

Collections of sales and use taxes have increased as the economy has grown and Wisconsin personal incomes have increased. In addition, the state tax rate was increased in 1969 to 4% and to 5% in 1982 and the tax base has been changed. Collections increased from \$83 million in FY65 to \$4,128 million in FY06. Sales and use taxes provided 14% of general purpose tax revenues in FY65, but that share had increased to 34% in FY06.

Table 2 shows the source of sales and use taxes by type of business. In calendar year 2005, 59.0% of sales and use taxes were collected from businesses engaged in retail trade while service industries accounted for 12.6%.

**TABLE 2  
WISCONSIN SALES AND USE TAXES BY NAICS, 2005**

NAICS	Descriptions	Filers	Total Taxes
11	Agricultural, Forestry, Hunting, and Fishing	1,340	\$4,545,677
233, 235	Construction	7,134	104,487,302
221, 454	Utilities and Other Fuel Dealers	276	252,449,539
	<b>SUBTOTAL: INFORMATION AND COMMUNICATIONS</b>	<b>1,815</b>	<b>\$272,471,891</b>
511	Publishing	672	15,663,083
512	Motion Picture, Video, and Sound Industries	152	2,196,015
513, 5141	Broadcasting, Telecommunications, and Information Services	991	254,612,793
	<b>SUBTOTAL: MANUFACTURING</b>	<b>6,879</b>	<b>\$158,215,559</b>
311, 312	Food, Beverage, and Tobacco Manufacturing	216	4,159,550
21, 32	Raw Materials Manufacturing, including Quarrying	1,252	36,942,397
324-327	Chemical and Nonmetallic Mineral Product Manufacturing	467	16,761,846
33	Mechanical, Machinery, Industrial, and Other Manufacturing	4,944	100,351,766
	<b>SUBTOTAL: RETAIL TRADE</b>	<b>75,094</b>	<b>\$2,373,789,984</b>
722	Food Services and Drinking Places (Restaurants and Bars)	14,732	313,862,457
711	Performing Arts, Spectator Sports, and Related Industries	994	18,127,306
713	Amusement, Gambling, Recreation Industries	1,374	22,115,628
441	Automobiles and Other Motor Vehicles	4,264	454,904,919
447100	Gasoline Stations (including convenience stores with gas)	1,767	58,454,683
448	Clothing and Accessories Stores	2,552	117,932,841
443	Electronic and Appliance Stores	1,176	72,118,841
445	Food and Beverage Stores	3,271	167,601,134
442, 444	Furniture and Home Furnishings Stores	5,298	319,891,551
446	Health and Personal Care Stores	655	33,353,290
451	Sporting Goods, Hobby, Book, and Music Stores	3,219	57,277,216
452, 453	General Merchandise Stores	1,391	379,032,328
453 et al.	Other Store Retailers	29,557	323,443,573
453, 454	Nonstore Retailers	4,844	35,674,216
	<b>SUBTOTAL: SERVICES</b>	<b>50,262</b>	<b>\$508,416,479</b>
721	Hotels, Motels, and Other Traveler Accommodations	3,663	71,098,098
52, 55	Banking, Insurance, and Other Finance Activities	964	16,116,692
561	Administrative and Support Services	1,405	19,285,208
62	Health Care and Social Assistance Services	2,349	7,397,860
812	Personal and Household Services	14,373	100,187,110
Various	Business Services	9,409	82,267,266
811	Repair and Maintenance Services	9,412	75,192,475
5411, 5412	Professional Services	543	1,350,812
5413	Architectural, Engineering, and Related Services	251	1,120,710
5415	Computer System Services	2,579	41,083,337
54	Scientific and Other Services	987	7,622,620
532	Rental and Leasing Services	3,675	83,101,826
531	Real Estate Services (Rental, Management, Appraisal)	652	2,592,463
	<b>SUBTOTAL: WHOLESALE</b>	<b>4,881</b>	<b>\$212,672,821</b>
421	Durable Goods – Wholesale	3,165	184,778,001
422	Nondurable Goods – Wholesale	1,716	27,894,820
	<b>MISCELLANEOUS</b>	<b>986</b>	<b>\$138,123,628</b>
48	Transportation	986	7,739,209
	<b>TOTAL</b>	<b>148,667</b>	<b>\$4,025,172,880</b>

### Calculations of Exemptions

This report describes each sales tax exemption and, where feasible, provides an estimate of its fiscal effect in FY06. In general, fiscal effects were estimated by obtaining or estimating the gross receipts from retail sales

for the most recent year available and adjusting those receipts to FY06 levels using income and price data. When possible, estimates are based on data specific to Wisconsin obtained from state and federal agencies and trade organizations with statewide membership or information. For some exemptions, state-specific data are not available; the fiscal effects of these exemptions were estimated from national sales data using Wisconsin's percentage of the nation's population, personal income or a similar indicator. For some exemptions, data on which to base an estimate are not available. For others, no estimate is made because the state is precluded from taxing the sale – for example, sales to the federal government, which are exempt under the U.S. Constitution.

The significance of these exemptions may be viewed from the perspective of actual sales and use tax collections, which were \$4,128 million in FY06. Thus, the exemption of "food, food products, and beverages," which is estimated to cost \$550 million in foregone tax revenues, represents over 13% of sales and use tax collections.

**TABLE 3  
SALES AND USE TAX EXEMPTION DEVICES SUMMARY**

Exemption	Statutory Reference*	FY06 Fiscal Effect
<b>Exemptions for Property Sold Primarily to Households</b>		
Food, Food Products, and Beverages	Sec. 77.54 (20) and (20m)	\$550,000,000
Meals Furnished by Institutions of Higher Education	Sec. 77.54 (20) (c) 5.	4,300,000
Water Sold Through Mains	Sec. 77.54 (17)	18,100,000
Fuel and Electricity for Residential Use	Sec. 77.54 (30) (a) 1. and 2.	127,200,000
Manufactured Homes and Mobile Homes Used as Primary Housing	Sec. 77.51 (4) (b) 6. and 7., (15) (b) 5 and 6, 77.54 (31)	1,300,000
Motor Fuels	Sec. 77.54 (11)	403,000,000
Newspapers, Periodicals, and Shoppers Guides	Sec. 77.54 (15)	15,300,000
Caskets and Burial Vaults	Sec. 77.54 (21)	4,500,000
U.S. and State of Wisconsin Flags	Sec. 77.54 (46)	Minimal
Coin-Operated Laundry and Dry Cleaning Services	Sec. 77.52 (2) (a) 6.	1,300,000
Cloth Diapers and Diaper Services	Sec. 77.51 (1m) and (3m), 77.52 (2) (a) 6. and 77.54 (40)	Minimal
Gun Club Admissions and Membership Fees	77.52 (2) (a) 2. b.	Effective 7/1/07
<b>Exemptions Related to Health Care</b>		
Prescription Drugs and Medicines (excluding Insulin)	Sec. 77.54 (14)	116,000,000
Insulin and Equipment Used in the Treatment and Testing of Diabetes	Sec. 77.54 (14m) and (28)	15,400,000
Medical Devices (inc. Wheelchairs, Home Oxygen Equipment)	Sec. 77.54 (14s) and (22)	13,100,000
Meals Provided by Nursing Homes, Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes	Sec. 77.54 (20) (c) 4.	Not available
<b>Exemptions Related to Farming</b>		
Tractors and Farm Machinery	Sec. 77.54 (3) (a)	25,400,000
Personal Property and Supplies Used in Farming	Sec. 77.54 (3m)	108,000,000
Electricity Used in Farming	Sec. 77.54 (30) (a) 3.	7,800,000
Fuel Used in Farming	Sec. 77.54 (30) (a) 5.	9,100,000
Veterinary Services and Medicines for Farm Livestock	Sec. 77.52 (2) (a) 10. and 77.54 (33)	6,900,000
Semen for Livestock Breeding	Sec. 77.54 (27)	2,700,000
Milkhouse Supplies	Sec. 77.54 (34)	5,800,000
<b>Exemptions Related to General Business</b>		
Machinery and Equipment Used in Manufacturing	Sec. 77.54 (5) (d) and (6) (a)	145,000,000
Fuel and Electricity Used in Manufacturing	Sec. 77.54 (30) (a) 6. Effective 1/1/06	28,000,000
Tangible Personal Property Consumed in Manufacturing	Sec. 77.54 (2)	Not available
Component Parts of Shoppers Guides, Newspapers, and Periodicals	Sec. 77.54 (2m)	Not available



**TABLE 3 (continued)**  
**SALES AND USE TAX EXEMPTION DEVICES SUMMARY**

Exemption	Statutory Reference*	FY06 Fiscal Effect
Fuels Converted to Electric Energy, Gas or Steam by Utilities	Sec. 77.54 (6) (c)	Not available
Waste Treatment Facilities and Machinery and Equipment Used in Recycling	Sec. 77.54 (5) (c), (26) and (26m)	Not available
Logging Equipment	Sec. 77.54 (39)	500,000
Equipment Used in the Production of Maple Syrup	Sec. 77.54 (29)	Minimal
Wood Residue Used as Fuel in a Business Activity	Sec. 77.54 (30) (a) 4.	170,000
Building Materials, Equipment, and Supplies Used in the Construction of Professional Sports Stadiums	Sec. 77.54 (41)	Not available
Live Game Birds and Clay Pigeons	Sec. 77.54 (47)	200,000
Trucks, Tractors, Buses, and Other Vehicles Sold to Common or Contract Carriers	Sec. 77.54 (5) (b)	19,000,000
Rolling Stock Used in Railroad Operations	Sec. 77.54 (12)	1,200,000
Commercial Vessels and Barges	Sec. 77.54 (13)	2,100,000
Containers, Labels, Sacks, Cans, Boxes, and Other Packaging and Shipping Materials	Sec. 77.54 (6) (b)	Not available
Motion Picture and TV Film and Advertising Materials	Sec. 77.54 (23m)	9,200,000
Restaurant Employee Meals	Sec. 77.54 (20) (c) 4m.	Not available
Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization	Sec. 77.56 (3)	Not available
Prepaid Telephone Cards and Authorization Numbers	Sec. 77.54 (46m)	Minimal
Broadband Equipment for Rural Areas	Sec. 77.51 (6m) and 77.54 (48) Effective 7/1/07	-0-
Sales to Affiliated Companies	Sec. 77.54 (49)	Not available
<b>Exemptions for Government Agencies and Nonprofit Organizations</b>		
Sales to the Federal Government and Its Agencies	Sec. 77.55 (1)	Not available
Sales to State and Local Governments and Schools	Sec. 77.54 (9a) (a)-(em), (g) and (h)	295,000,000
Religious, Charitable, Scientific, and Educational Organizations	Sec. 77.54 (9a)(f)	137,000,000
Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools	Sec. 77.54 (4)	10,400,000
Admissions to Elementary and Secondary School Activities	Sec. 77.54 (9)	800,000
Admissions to State Parks and Camping Fees	Sec. 77.54 (10)	700,000
Admissions to Certain Historical Museums	Sec. 77.54 (10)	23,000
Admissions to County Fairs	Sec. 77.52 (2) (a) 2.	Not available
Volunteer Fire Department Equipment	Sec. 77.54 (16)	Minimal
Copies of Public Records	Sec. 77.54 (32)	Minimal
Sales by American Legion Baseball Teams	Sec. 77.54 (35)	Not available
Snowmobile Trail Grooming Equipment	Sec. 77.54 (38)	Minimal
Charges for 911 and E-911 Emergency Telephone Systems	Sec. 77.51 (15) (b) 7. and 77.54 (37)	1,200,000
Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection	Sec. 77.54 (42)	4,000
Public Benefits Fees	Sec. 77.54 (44)	6,200,000
One-time License or Right to Purchase Admissions to Professional Football Games	Sec. 77.54 (45)	30,000
Motor Vehicles Loaned to Driver Education Programs	Sec. 77.56 (2)	Minimal
Interstate Commerce	Sec. 77.54 (1)	Not available
Property Used in Wisconsin by Nonresidents	Sec. 77.53 (17)	Not available
Nonresidents' Boats Berthed in Boundary Waters	Sec. 77.53 (17m)	Not available
Nonresidents' Aircraft Hangared in Wisconsin	Sec. 77.53 (17r)	Not available
Goods Brought into the State by New Residents	Sec. 77.53 (18)	Not available

**TABLE 3 (continued)**  
**SALES AND USE TAX EXEMPTION DEVICES SUMMARY**

Exemption	Statutory Reference*	FY06 Fiscal Effect
<b>Exemptions for Nonresidents and for Use in Other States</b>		
Property Purchased for Use Outside the State	Sec. 77.55 (3)	Not available
Aircraft, Motor Vehicles, and Truck Bodies Sold for Use Outside the State	Sec. 77.54 (5)(a)	Not available
Property Sold to Out-of-State Common or Contract Carriers	Sec. 77.55 (2) and (2m)	Not available
Printed Advertising Material Used Outside the State	Sec. 77.54 (25)	Not available
Temporary Storage of Printed Materials	Sec. 77.54 (43)	Not available
<b>Definitional and Miscellaneous Exemptions</b>		
Exemptions That Further Define Retail Sales	See text	Not available
Labor Input into Construction	Sec. 77.51 (4) (c) 4. and 77.52 (2) (a) 10.	715,000,000
Trade-Ins and Lemon Law Refunds	Sec. 77.51 (4) (a) 3., (b) 3m. and (15) (b) 4m.	123,000,000
Transportation Charges	Sec. 77.51 (4) (b) 5. and (15)(b) 3.	Not available
Occasional Sales	Sec. 77.54 (7) and (7m)	Not available
Auction Sales	Sec. 77.51 (9) (e)	Not available
Retailer's Discount	Sec. 77.61 (4) (c)	23,800,000

\* References are to the 2003-04 Wisconsin Statutes.

## **EXEMPTIONS FOR PROPERTY SOLD PRIMARILY TO HOUSEHOLDS**

### **Food for Home Consumption**

Sales of food, food products, and beverages purchased for home consumption are exempt from sales tax. However, items such as candy, soda water beverages, beer, wine, and liquor are taxable. Sales of food, food products, and beverages from vending machines are treated as exempt sales for home consumption. When exempt food items are packaged with taxable items, the package is exempt if at least 50% of the price is attributable to the exempt items. Food for direct consumption on the premises, such as meals sold in restaurants, cafes, and cafeterias are taxable.

### **Meals Furnished by Institutions of Higher Education**

Sales of meals, food, and beverages furnished by public and private institutions of higher education are exempt from sales tax if they are furnished to students enrolled in that institution or under an agreement with a National Football League team.

### **Water Sold Through Mains**

Sales of water delivered through mains and sales of water by public and private water utility districts are exempt from the sales tax.

### **Fuel and Electricity for Residential Use**

All sales for residential use of coal, fuel oil, propane, steam, peat, fuel cubes produced from solid waste, and sales of wood used for fuel for residential use are exempt from sales tax. Sales of electricity and natural gas for residential use billed from November through April are also exempt from sales tax.

### **Manufactured Homes and Mobile Homes Used as Primary Housing**

Thirty-five percent of the sales price of a new mobile home to be used as primary housing is exempt from sales tax if the home is at least 45 feet in length or is transported in two sections with a total area of 984 square feet. Sales of used mobile homes used as primary housing and meeting the size requirements are fully exempt. A portion of the sales price of a manufactured home, equal to either 35% of the price or the gross receipts less the amount attributable to materials, is also exempt.

**Motor Fuels**

Sales of motor fuels that are subject to the state motor fuel excise tax are exempt from the sales tax. Exempt fuels include gasoline, commercial, and general aviation fuel, and diesel fuel.

**Newspapers, Periodicals, and Shoppers Guides**

Sales of newspapers, periodicals sold by subscription, and shoppers guides that distribute at least 48 issues in a 12-month period are exempt from sales tax. The exemption for newspapers and periodicals is generally limited to those published four or more times per year; periodicals issued at intervals not exceeding six months by an educational association or tax-exempt religious, charitable, scientific or educational organization are also exempt.

**Caskets and Burial Vaults**

Sales of caskets and burial vaults are exempt from sales tax.

**United States of America and State of Wisconsin Flags**

Sales of U.S. and Wisconsin flags are exempt from sales tax.

**Coin-Operated Laundry and Dry Cleaning Services**

Laundry, dry cleaning, pressing, and dyeing services performed by customers using coin-operated equipment are exempt. These services are also exempt when performed on raw materials or goods in process destined for sale.

**Cloth Diapers and Diaper Services**

Gross receipts from the sale or rental of cloth diapers and gross receipts of diaper services are exempt.

**Gun Club Admissions and Memberships**

Sales of admissions, including memberships, by a gun club are exempt beginning July 1, 2007, if the gun club is a nonprofit organization and if the gun club provides safety classes approved by the Department of Natural Resources to at least 25 individuals in the calendar year. Gun clubs include trapshooting, skeet-shooting, sporting-clay, hunting, rod and gun, hunting and fishing, and conservation clubs.

**EXEMPTIONS RELATED TO HEALTH CARE****Prescription Drugs and Medicines**

Sales of medicines are exempt from sales and use tax if the medicines are: (1) prescribed for treatment by an authorized person or dispensed by a registered pharmacist; (2) furnished by a licensed physician, surgeon, podiatrist or dentist to his own patient; (3) furnished by a hospital for treatment of patients on the orders of a licensed physician, surgeon, podiatrist or dentist; (4) sold to a licensed physician, surgeon, podiatrist or dentist for treatment of patients; (5) sold to this state or a political subdivision or any municipal corporation thereof for use in treatment of human beings or furnished by a medical facility maintained by the state; (6) furnished for the treatment of a human being by a medical facility or clinic maintained by the state or a political subdivision or any municipal corporation thereof, or (7) furnished without charge to a physician, surgeon, nurse anesthetist, advanced practical nurse, osteopath, dentist, podiatrist or optometrist if the medicine may not be dispensed without a prescription.

**Insulin and Equipment Used in the Treatment and Testing of Diabetes**

Insulin and apparatus used for the injection of insulin, other equipment used to treat diabetes, and equipment and supplies used to measure blood sugar levels are exempt from sales tax.

**Medical Devices**

Medical devices, including repair parts and accessories, are exempt from sales tax. Exempt devices include wheelchairs and crutches; artificial limbs, eyes, and teeth; prescription eye glasses; hearing aids; equipment used to administer prescription oxygen; prescription antiembolism hose and stockings; and adaptive equipment to enable a handicapped person to enter, operate, and leave a motor vehicle.

**Meals Provided by Nursing Homes, Community-Based Residential Facilities and Hospitals, and Food Sold in Retirement Homes**

Sales of meals and food by and served on the premises of hospitals, sanatoriums, nursing homes, community-based residential facilities, day care centers, and retirement homes are exempt from the sales tax. A "retirement home" is a nonprofit residential facility where three or more unrelated adults or their spouses have their principal residence and where support services, including meals from a common kitchen, are available to residents.

**EXEMPTIONS RELATED TO FARMING****Tractors and Farm Machinery**

Sales of tractors and farm machinery, including accessories, attachments, and parts used directly in farming are exempt from sales tax. The exemption does not apply to motor vehicles for highway use, such as cars and trucks. Act 336 (2005), which takes effect July 1, 2007, expanded the exemption to include sales of tangible personal property that is used exclusively and directly, or is consumed or loses its identity, in the business of agriculture or silviculture.

**Personal Property and Supplies Used in Farming**

Sales of seeds; plants; feed; fertilizer; soil conditioners; animal bedding; sprays, pesticides, and fungicides; breeding and other livestock; farm work stock; baling twine and baling wire; containers; and plastic bags, sleeves, and sheeting used to store or cover hay or silage are exempt from sales tax.

**Electricity Used in Farming**

Electricity sold for use in farming is exempt from sales tax.

**Fuel Used in Farming**

Fuel sold for use in farming is exempt from sales tax.

**Veterinary Services and Medicines for Farm Livestock**

Sales of services provided by veterinarians for animal health care, breeding or training of livestock, and sales of medicines used to treat farm livestock, are exempt from sales tax.

**Semen for Livestock Breeding**

The sale of semen used for the artificial insemination of livestock is exempt from sales tax.

**Milkhouse Supplies**

Sales of milkhouse supplies used exclusively in producing and handling milk on dairy farms are exempt from sales tax.

**EXEMPTIONS RELATED TO GENERAL BUSINESS****Machinery and Equipment Used in Manufacturing**

The sale and use of machines and specific processing equipment and repair parts used exclusively and directly by a manufacturer in the manufacturing process are exempt from sales tax. Generally, manufacturing is defined as the production by machinery from existing materials of a new article of tangible personal property with a different form, use or name. Mobile mixing and processing units, including the vehicles on which they

are mounted, are also exempt manufacturing machinery and equipment.

### **Fuel and Electricity Used in Manufacturing**

Fuel and electricity used in manufacturing tangible personal property are exempt from sales and use tax as of January 1, 2006. Prior law provided a corporate income and franchise tax credit for sales and use tax paid on fuel and electricity used in manufacturing.

### **Tangible Personal Property Consumed in Manufacturing**

Tangible personal property, typically raw materials and other inputs, that is consumed, destroyed or loses its identity in manufacture of finished goods is exempt from sales tax.

### **Component Parts of Shoppers Guides, Newspapers, and Periodicals**

Materials and services that become component parts of shoppers guides, newspapers, and periodicals are exempt from sales tax.

### **Fuels Converted to Electric Energy, Gas or Steam by a Utility**

Fuels converted to electric energy, gas or steam by a utility are exempt from sales tax.

### **Waste Treatment Facilities and Machinery and Equipment Used in Recycling**

Sales and installation of waste treatment (pollution control) facilities, replacement parts, and chemicals and supplies used in operating a waste treatment facility are exempt from the sales tax. The exemption applies to expenditures by governmental units, private industry and their construction contractors for sewage treatment plants, holding ponds, and similar facilities. The sale and use of machinery and equipment and repair parts used exclusively and directly for waste reduction or recycling activities are exempt. Also exempt are motor vehicles used exclusively and directly in recycling that are not required to be licensed for highway use. The activities qualifying for the exemption include those that reduce the amount of solid waste generated, recover energy from solid waste, and reuse, recycle or compost solid waste. Some recycling machinery is also exempt as manufacturing machinery.

### **Logging Equipment**

Off-highway, heavy mechanical equipment used in the harvesting or processing of raw timber products in the field by loggers is exempt from sales tax.

### **Equipment Used in the Production of Maple Syrup**

Equipment used in the production of maple syrup is exempt from sales tax.

### **Wood Residue Used as Fuel in a Business Activity**

The sale of residue from the harvesting of timber for use as a fuel in a business activity is exempt from sales tax.

### **Building Materials, Equipment, and Supplies Used in the Construction of Professional Sports Stadiums**

Sales of building materials, equipment, and supplies used solely in the construction of a sports stadium built or used by a professional sports team are exempt from the sales tax. This exemption applies to the Miller Park constructed by the Southeast Wisconsin Professional Baseball Park District and to Lambeau Field constructed by the Green Bay-Brown County Professional Football Stadium District.

### **Live Game Birds and Clay Pigeons**

Sales of live game birds and clay pigeons to licensed bird hunting preserves are exempt. Also exempt are sales of clay pigeons to a shooting facility if the shooting facility pays sales tax on its charges for shooting or the shooting facility is a nonprofit organization whose charges for shooting are exempt occasional sales.

**Trucks, Tractors, Buses, and Other Vehicles Sold to Common or Contract Carriers**

Sales of trucks, truck tractors, buses, trailers and semi-trailers and accessories, parts, and supplies sold to common or contract carriers are exempt from sales tax. This exemption applies to urban mass transportation, bus and trucking companies, and other contract carriers.

**Rolling Stock Used in Railroad Operations**

Sales of locomotives, freight cars, and other rolling stock as well as accessories, attachments, and fuel and lubricants used in railroad operations are exempt from sales tax.

**Commercial Vessels and Barges**

Sales, storage, use or other consumption of commercial vessels and barges in excess of 50 tons and primarily engaged in interstate or foreign commerce or commercial fishing are exempt from sales tax. Accessories, parts, and fuel for these vessels are also exempt from sales tax.

**Containers, Labels, Sacks, Cans, Boxes, and Other Packaging and Shipping Materials**

Sales of containers, labels, sacks, cans, boxes, and other packing, packaging, and shipping materials, if such materials are used to transfer merchandise to customers, are exempt from sales tax. Packing, packaging, and shipping materials, including meat casings, for use in meat packing, packaging or shipping meat are exempt from sales tax regardless of whether such materials are used to transfer merchandise to customers.

**Motion Picture and TV Film and Advertising Materials**

The sale, lease, rental or storage, use or other consumption of motion picture films and of advertising material sold, leased or rented to movie theaters or radio or television stations is exempt from sales tax.

**Restaurant Employee Meals**

Meals that are provided by a restaurant to the restaurant's employee during the employee's work hours are exempt from sales tax.

**Tangible Personal Property Purchased for Resale but Donated to a Nonprofit Organization**

Property purchased tax-free for resale or under a valid exemption certificate and later donated to a nonprofit organization is exempt from use tax.

**Prepaid Telephone Cards and Authorization Numbers**

Services obtained by the use of a prepaid telephone card or authorization number are exempt from sales tax if sales tax was paid on the card or authorization number at the time it was purchased.

**Broadband Equipment for Rural Areas**

Sales of Internet equipment used in the broadband market if the purchaser certifies to the Wisconsin Department of Commerce that the purchaser will, within 24 months after July 1, 2007, make an investment that is reasonably calculated to increase broadband availability in the state.

**Sales to Affiliated Companies**

Sales of taxable services and tangible personal property that is physically transferred to the purchaser if the seller and purchaser of such services and property are of the same affiliated group under the Internal Revenue Code and are eligible to file a consolidated federal income tax return.

## **EXEMPTIONS FOR GOVERNMENT AGENCIES AND NONPROFIT ORGANIZATIONS**

### **Sales to the Federal Government and Its Agencies**

Sales of goods and services to the federal government or to any of its incorporated or unincorporated agencies or instrumentalities are exempt from sales tax. Taxing purchases by the federal government would violate the U.S. Constitution.

### **Sales to State and Local Governments and Schools**

Sales of tangible personal property and taxable services to the state or any of its agencies are exempt. Also exempt are sales to the University of Wisconsin Hospitals and Clinics Authority, the Wisconsin Aerospace Authority, the Health Insurance Risk-sharing Plan Authority, and the Fox River Navigational System Authority. In addition, sales to county, city, village, and town governments; school districts; local exposition districts; local cultural arts districts; joint local water authorities; sewerage commissions; and metropolitan sewerage districts are exempt from sales tax.

### **Sales to Religious, Charitable, Scientific, and Educational Organizations**

The gross receipts from sales to, and the storage, use or other consumption of tangible personal property and taxable services by any corporation, community chest, foundation or association organized and operated exclusively for religious, charitable, scientific or educational purposes or for the prevention of cruelty to children or animals, except specified hospital service corporations, are exempt from sales tax if no part of the net income of the organization inures to the benefit of any private person.

### **Lunches and Other Tangible Personal Property Sold by Elementary and Secondary Schools**

Sales of tangible personal property by public or private elementary and secondary schools are exempt from sales tax.

### **Admissions to Elementary and Secondary School Activities**

Sales of tickets or admissions to public and private elementary and secondary school activities are exempt from the sales tax, if the net proceeds are used for educational, religious or charitable purposes. The exemption includes revenue from admission fees to high school sporting events, school plays, and other school activities.

### **Admissions to State Parks and Camping Fees**

Admission fees and camping fees at state park and state forest recreational areas are exempt from sales tax.

### **Admissions to Certain Historical Museums**

Admissions to a museum operated by a nonprofit corporation under a lease agreement with the State Historical Society are exempt from sales tax. This exemption applies only to the Circus World Museum in Baraboo.

### **Admissions to County Fairs**

Admissions to county fairs are exempt from sales tax.

### **Volunteer Fire Department Equipment**

Sales of fire trucks and other fire-fighting equipment to volunteer fire departments are exempt from sales tax. This exemption includes hoses, exhaust fans, generators, ladders, and other firefighting equipment.

### **Copies of Public Records**

Charges by a governmental authority for copies of public records, including fees for searches, are exempt from sales tax.

### **Sales by American Legion Baseball Teams**

Sales of tangible personal property, tickets, and admissions by American Legion baseball teams are exempt from sales tax.

#### **Snowmobile Trail Grooming Equipment**

Snowmobile trail groomers and attachments are exempt from sales tax when purchased by snowmobile clubs for use in maintaining the state system of snowmobile trails. To qualify for the exemption, an organization must meet at least three times a year and have at least 20 members.

#### **Charges for Emergency Telephone Systems**

Charges levied by a county or group of counties to finance an emergency (911) telephone system are exempt from sales tax. Charges imposed by the Public Service Commission of Wisconsin (PSCW) to fund implementation of enhanced (E911) emergency services are also exempt. The PSCW set the E911 charge at \$0.83 per month for the three years beginning in December 2005.

#### **Sales of Animal Identification Tags and Samples by the Department of Agriculture, Trade and Consumer Protection**

Sales by the Wisconsin Department of Agriculture, Trade and Consumer Protection of animal identification tags to persons who are required or authorized to use those identification tags and sales of standard samples representing product or commodity grades are exempt from sales tax.

#### **Public Benefits Fees**

Public benefits fees are exempt from sales tax. These fees are surcharges on residential and commercial electric bills used to fund low-income energy assistance and energy conservation and efficiency programs.

#### **One-Time License or Right to Purchase Admissions to Professional Football Games**

The sale by a municipality, a local professional football stadium district or a professional football team of a one-time license or similar right to purchase admission to at least three games at a football stadium in a season is exempt from sales tax. The exemption applies to the sale of admission rights whose proceeds are used to finance renovation of Lambeau Field in Green Bay.

#### **Motor Vehicles Loaned to Driver Education Programs**

The loan by an automobile dealer of a motor vehicle for a driver education program conducted by a school or school district is exempt from use tax.

### **EXEMPTIONS FOR NONRESIDENTS AND FOR USE IN OTHER STATES**

#### **Interstate Commerce**

Tangible personal property shipped in interstate commerce is not subject to sales tax. The fiscal effect of this exemption has not been estimated because taxing such property is prohibited by the U.S. Constitution.

#### **Property Used in the State by Nonresidents**

Tangible personal property brought into the state by nonresidents of Wisconsin for their own use, storage or other consumption while temporarily in Wisconsin is exempt from use tax. However, if the property is used to conduct a trade, business or profession, or used in the performance of personal services for wages or fees, the value of the property is subject to the tax.

#### **Nonresidents' Boats Berthed in Boundary Waters**

Generally, a boat that is owned by a resident of another state and berthed in Wisconsin is subject to use tax, if the owner did not pay sales tax when purchasing the boat. However, the boat is exempt from use tax if: (1)

the boat owner is a resident of a state contiguous to Wisconsin, (2) the boat is berthed in boundary waters adjacent to the owner's state of residence, and (3) the purchase of the boat was an exempt occasional sale.



**Nonresidents' Aircraft Hangared in Wisconsin**

Aircraft purchased in another state by a nonresident individual or business and kept in a hangar in Wisconsin is exempt from use tax.

**Goods Brought into the State by New Residents**

Household goods purchased outside of Wisconsin but brought into the state by new residents are exempt from use tax if the goods are purchased 90 or more days prior to the date the person moves to Wisconsin. This exemption applies to all household goods, including automobiles and other registered vehicles, purchased for personal use.

**Property Purchased for Use Outside the State**

Sales of tangible personal property are exempt from use tax, if purchased for use solely outside this state and delivered to a forwarding agent, export packer or other person engaged in the business of preparing goods for export or arranging for their exportation, and actually delivered to a port outside the continental limits of the United States prior to first use of the property.

**Aircraft, Motor Vehicles, and Truck Bodies Sold for Use Outside the State**

Sales of aircraft, motor vehicles, and truck bodies to nonresidents who will not use such units in Wisconsin are exempt from the sales tax. This exemption also applies to aircraft, motor vehicles, and truck bodies sold to foreign governments and to certified carriers of people or property in interstate or foreign commerce.

**Property Sold to Out-of-State Common or Contract Carriers**

Sales of tangible personal property to common or contract carriers engaged primarily in trucking and sales to railroad companies are exempt from sales tax, if the property is shipped to a destination outside this state. , For example, Wisconsin is a major producer of railroad ties and all shipments of railroad ties out of state are exempt from sales tax.

**Printed Advertising Material Used Outside the State**

Sales of printed advertising materials produced in Wisconsin and sold to purchasers for use only outside the state are exempt from sales tax. For example, advertising leaflets, which are printed and purchased in the state but distributed only in a neighboring state, are not subject to sales tax.

**Temporary Storage of Printed Materials**

The temporary storage of raw materials that are incorporated into printed materials to be transported outside Wisconsin, and thereafter used solely outside Wisconsin, are exempt from sales and use tax. An example of printed materials qualifying for the exemption would be paper purchased by a company from an out-of-state vendor and delivered to a Wisconsin printer that prints catalogs for the purchaser, if the catalogs are distributed only outside Wisconsin.

**DEFINITIONAL AND MISCELLANEOUS EXEMPTIONS****Exemptions That Further Define Retail Sales**

The purpose of this exemption report is to estimate the cost to the state of providing specific exemptions to the sales tax for items that would otherwise be taxable. A retail sale is defined as one where the buyer makes a purchase with no intention of resale. By law, retail sales are subject to the sales tax, unless otherwise provided by law. However, some sections of the statutes clarify the definition of a retail sale to exclude certain transactions from tax. For these sections no fiscal estimates have been made because sales of these items are not retail sales.

The following transactions fall into this category:

- Charges for interest, financing or insurance when such charges are stated separately. [Sec. 77.54 (8)].
- Transfer of property to a corporation upon its organization solely in consideration for the issuance of its stock. [Sec. 77.51 (14g) (a)].
- Contributions of property to a newly-formed partnership solely in consideration for a partnership interest. [Sec. 77.51 (14g) (b)].
- Contributions of property to a limited liability company upon its organization solely in consideration for a membership interest. [Sec. 77.51 (14g) (bm)].
- Transfer of property to a corporation for the issuance of its stock pursuant to a merger or consolidation. [Sec. 77.51 (14g) (c)].
- Transfer of property to a limited liability company for a membership interest pursuant to a merger. [Sec. 77.51 (14g) (cm)].
- Distribution of property by a corporation to its stockholders as a dividend or in liquidation. [Sec. 77.51 (14g) (d)].
- Distribution of property by a partnership to its partners in liquidation. [Sec. 77.51 (14g) (e)].
- Distribution of property by a limited liability company to its members in liquidation. [Sec. 77.51 (14g)(em)].
- Repossession of property when the only consideration is cancellation of the purchaser's obligation to pay the balance of the purchase price. [Sec. 77.51 (14g) (f)].
- Transfers of property in a reorganization in which no gain or loss is recognized for Wisconsin franchise or income tax purposes under sections 71.301 to 71.368. [Sec. 77.51 (14g) (g)].
- Accounts that are found to be worthless, uncollectible, and charged off for income tax purposes. [Sec. 77.51 (4) (b)4 and 77.52 (6)].
- The portion of a sales price that is either refunded in cash or credit as a result of property returned. [Sec. 77.51 (4) (b)2].
- The transfer of electric transmission facilities to a transmission company. [Sec. 77.51 (14g) (fm)].

### **Labor Input into Construction**

Materials used in construction are subject to sales tax; however, the value added by construction contractors is not taxed. Construction is a volatile sector of the economy and, as a result, the value of this exemption fluctuates from year to year.

### **Trade-Ins and Lemon Law Refunds**

In transactions in which a product is traded in on the purchase of a product of greater value, sales tax is applied only to the difference between the values of the two products. The estimate applies only to trade-ins of automobiles and trucks; it does not include trade-ins of boats, mobile homes, household appliances or other items. Also, a customer purchasing a replacement vehicle with a lemon law refund may apply the value of the original trade-in to the purchase of the replacement vehicle.

### **Transportation Charges**

Transportation charges are exempt from sales tax if the charges are stated separately, and if the transportation occurs after the purchaser takes possession of the property.

**Occasional Sales**

Occasional sales are sales by persons other than those offering goods for sale in the ordinary course of business. Taxable occasional sales include sales of automobiles, aircraft, trailers, semi-trailers, snowmobiles, all-terrain vehicles, and mobile homes not exceeding 45 feet in length, registered in the state, and boats registered in the state or in the U.S. However, these occasional sales are exempt only if the transfer is to a spouse, parent or child, or the spouse of a parent or child, and if the item had previously been registered in Wisconsin, or in the case of boats, registered in the state or in the U.S. Also, the transfer of a motor vehicle from an individual to a corporation solely owned by that individual is exempt. Occasional sales of tangible personal property or services by a neighborhood association, church, civic group or similar nonprofit organization are generally exempt from sales tax if total payments for entertainment or other expenses do not exceed \$500 and the organization's annual receipts do not exceed \$25,000.

**Auction Sales**

Gross receipts from auctions of farm personal property or household goods that are not held at regular intervals are exempt from sales tax.

**Retailer's Discount**

Retailers may retain 0.5% of their tax liability or a minimum of \$10 per filing period as compensation for the costs of collecting and remitting sales taxes.

**SERVICES NOT SUBJECT TO TAX**

Services are exempt from sales tax unless the statutes specifically impose the tax. Data are not available to estimate the total cost of not taxing services. However, the following table shows certain services that are not subject to sales tax and provides an estimate of the potential fiscal effect. The table does not include services that are specifically exempted from tax by law and discussed in previous sections, such as coin-operated laundry services, diaper services, veterinary services for farm animals, and labor services in construction.

**TABLE 4  
SALES AND USE TAX EXEMPTIONS-SERVICES**

Exemption	FY06 Fiscal Effect
<b>Personal and Recreational Services</b>	
Beauty, Barber, Nail, and Other Personal Care Services	\$28,000,000
Funeral Services, excluding Caskets and Vaults	8,900,000
Dues and Fees Paid to Business Associations and Fraternal Organizations	13,500,000
Health Clubs	11,500,000
Admissions to Educational Events and Places	6,200,000
Veterinary Services for Pets	15,300,000
Auto and Travel Clubs	2,500,000
<b>Professional Services</b>	
Services of Physicians, Dentists, and Other Health Professionals	495,000,000
Legal Services	119,000,000
Architectural, Engineering, Testing Laboratory, and Surveying Services	63,000,000
Accounting Services	51,000,000
Tax Preparation Services	4,000,000
<b>Business Services</b>	
Computer Services (inc. data processing and custom programming)	123,000,000
Management, Scientific, and Technical Consulting Services	60,000,000
Scientific Research and Development Services	16,000,000
Employment Placement Services	4,800,000
Public Relations	2,900,000
Credit Rating and Collection Services	6,800,000
Investigation and Security Services	17,100,000
<b>Services Related to Real Property</b>	
Commissions to Real Estate Brokers	50,000,000
Repair of Real Property	38,000,000
Interior Design	2,100,000
Janitorial Services	24,700,000
Disinfecting and Exterminating	3,000,000
Sewerage Services	25,300,000

## INSURANCE PREMIUM TAXES

### Introduction

Chapter 76 of the Wisconsin Statutes provides for the taxation of certain insurance companies by the Commissioner of Insurance on the basis of premiums or net investment income. Insurance business subject to taxation under Chapter 76, Wis. Stats., is not subject to the corporate income and franchise tax under Chapter 71, Wis. Stats., and vice versa. Some types of insurance companies are not subject to taxation under either chapter.

The tax imposed by Chapter 76, Wis. Stats., may apply to all insurance companies, foreign (companies organized outside Wisconsin) as well as domestic (organized in Wisconsin). The corporate franchise tax applies to domestic fire and casualty insurers and the nonlife business of domestic life insurers.

Insurers exempt from taxation under both Chapters 71 and 76, Wis. Stats., include: fraternal or mutual benefit societies; town mutual insurance companies (except that fire dues are payable equal to 2% of the fire premiums); voluntary benefit plans for injury or death of students; self-insurers (except that fire dues are payable equal to 2% of the premiums that would have been charged by authorized insurers); the State Property Insurance Fund (except for fire dues on nonstate-owned property); and the Wisconsin Health Care Liability Plan and Patients Compensation Fund.

Insurance companies subject to the corporate income and franchise tax are subject to the same tax rate as that imposed on all other corporations subject to the tax, except that the tax is limited to 2% of premiums. The tax rates for insurance companies subject to taxation under Chapter 76, Wis. Stats., vary depending on the type of insurance business. In addition, because of the "reciprocal and retaliatory" statutes, Wisconsin taxation of foreign insurance companies (companies organized outside the state) is dependent on the taxation of Wisconsin-organized insurance companies in the domicile of such foreign companies. For example, the Wisconsin taxation of a New York company doing business in Wisconsin is dependent on the New York taxation of a Wisconsin company doing business in New York.

The Wisconsin "retaliatory" statute provides, in essence, that when the taxes/fees imposed by another state or country on insurers organized under Wisconsin laws doing business in that state or country are greater than the taxes or fees imposed by Wisconsin on those foreign insurers doing business in Wisconsin, then Wisconsin will tax insurers organized under the laws of the other state or country at the same higher rate.

The Wisconsin "reciprocal" statute provides that insurers organized under the laws of other states, territories or districts of the United States (but not other countries) shall not pay taxes, fees or licenses to Wisconsin greater than the taxes, fees or licenses imposed by the other state, territory or district on similar Wisconsin insurers doing business there. The reciprocal statute does not result in pure reciprocity because it does not apply to insurance companies organized in other countries, and it does not permit payment of less than the Wisconsin statutory tax on life insurance, fire dues (2% fire department dues), and certain fees. In addition, it requires a minimum tax of 0.375% on fire and ocean marine premiums.

Because some Wisconsin companies do insurance business in all other states, territories or districts of the United States, the effect of the reciprocity and retaliation statutes is that few U. S. fire or casualty insurers are taxed at the rates provided in the Wisconsin Statutes (except the 0.375% minimum tax on fire and ocean marine premiums). In general, the "retaliatory" statutes applicable to insurers organized in other countries cannot be applied because of limitations imposed by international treaties between the United States and the insurer's domiciliary country or because of practical problems of application or computation. Thus, non-U S. insurers are taxed at the Wisconsin statutory rate. The statutory rates are as follows: fire, 2.375%; ocean marine, 0.5%; casualty, 2%; domestic life (over \$750 million in force), 2%; domestic life (\$750 million or less in force), 3.5% of gross income (this tax plus a valuation fee is subject to a maximum of 2% of net taxable premiums); nondomestic life, 2%; and nondomestic accident and health, 2%.

For the premium tax, the base is gross premiums received for direct insurance less return premiums and cancellations and policyholder dividends from savings and gains on direct insurance in Wisconsin. Direct insurance includes all insurance other than reinsurance. Under reinsurance, an insurer shares the risk and premiums with other insurers.

General purpose tax collections from the insurance premiums taxes in FY 2006 were \$126.1 million. This excludes \$16.2 million of fire department dues which, beginning in FY82, were changed from general purpose to program revenue. Fire department dues are distributed to local units of government, while other insurance company taxes are part of the state general fund.

<b>Insurance Premium Taxes Summary</b>		
<b>Exemption Device</b>	<b>Statutory Reference<sup>1</sup></b>	<b>FY06 Fiscal Effect</b>
<b>Exemptions from Taxation</b>		
Town Mutual Insurance Companies	s. 76.61	\$1,428,000
Domestic Fire, Marine, and Casualty Companies	ss. 76.60 and 76.63 (1)	\$209,981,000
Fraternal Life Insurance Companies	s. 76.65	\$4,613,000
<b>Exemptions From Base</b>		
Return Premiums and Cancellations on Direct Insurance	ss. 76.60, 76.62 and 76.63 (1)	See Footnote 2
Exemptions from the Domestic Life Insurance Company Gross Income Tax Base	s. 76.65 (1)	\$0
Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base	s. 76.65 (2)	\$1,117,000 <sup>3</sup>
<b>Special Treatment</b>		
Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force	s. 76.65 (1)	None
"Retaliatory" Statute	s. 76.66	Not Available
"Reciprocity" Statute	s. 76.67	\$40,800,000
<b>Credits</b>		
Credit to Domestic Life Insurers for Personal Property Taxes	s. 76.69	\$679,000
Credit to Insurers to Recoup Security Fund Assessments	s. 646.51 (7)	\$0**
Credit to Insurers for Certified Capital Investment	s. 76.635 (2)	\$5,037,000
Health Insurance Risk-sharing Pool Assessment Credit	ss. 71.28 (5g) and 71.47 (5g)	See Footnote 4

1. References to sections of the 2005 Wisconsin Statutes.

2. Included in estimates for exemption for domestic, fire, marine, and casualty companies and for "reciprocity" statute.

3. Fiscal effect for domestic insurers only. Fiscal effect for foreign corporations included in the estimate for "reciprocity" statute.

4. The provision does not take effect until after FY 2006. Therefore there is no FY06 fiscal effect.

## EXEMPTIONS FROM TAXATION

### Town Mutual Insurance Companies

Town mutual insurance companies organized under or subject to Chapter 612 of the Wisconsin Statutes are not subject to taxation or license fees under Chapter 76, Wis. Stats. They are subject, however, to a fire dues tax of 2% of direct fire premiums. A town mutual insurance corporation may be organized by at least 100 adults, each of whom has a separate insurable risk within a prescribed territory. The territory may not exceed eight contiguous counties; however, the Commissioner of Insurance may allow a broader territory not larger than sixteen contiguous counties. A town mutual may insure members against loss or damage from any cause to any property in which a member has an interest, including insurance against loss of use or loss of income from property. The insurance of crops and other property against loss due to windstorm or hail are restricted and must be reinsured. Town mutual insurers may insure policy

holders from liability, errors and omissions and medical payments and other supplemental coverage when reinsured.

### **Domestic Fire, Marine and Casualty Companies**

Wisconsin-organized insurance companies insuring fire, marine, and casualty risks are not subject to Wisconsin premium taxation with the exception of mortgage guaranty insurers. Companies not subject to the premiums tax are subject to the corporation franchise tax. They are subject to a fire dues tax of 2% of direct fire premiums written. Casualty risks also include all lines of accident and health insurance written by life companies, fraternal insurers, health maintenance organizations, limited service health organizations, and health medical dental indemnity insurers.

### **Fraternal Life Insurance Companies**

All corporations transacting life insurance business in Wisconsin are subject to taxation under Chapter 76, Wis. Stats., except fraternal insurers organized and operating under Chapter 614 of the Wisconsin Statutes. A fraternal insurer must have a lodge system and a representative form of government. It must exist solely for the benefit of its members and their beneficiaries and solely for any lawful social, intellectual, educational, charitable, benevolent, moral, fraternal, patriotic or religious purposes for the benefit of its members or the public, carried on through voluntary activity of its members in their local lodges or through institutional programs of the fraternal insurer or its lodges. It may carry only life and accident and health lines of insurance.

## **EXEMPTIONS FROM BASE**

### **Return Premiums and Cancellations on Direct Insurance**

For the tax on fire, marine, and casualty insurance premiums, the tax base is defined as gross premiums as calculated under section 76.62, Wis. Stats. This section provides that all license fees and taxes levied under any provision of law upon gross premiums other than life insurance premiums shall be based on gross premiums received for direct insurance, less return premiums and cancellations, and returns from savings and gains on all insurance, other than reinsurance by the insurer during the preceding year in this state.

Reinsurance, whereby one insurer shares a portion of the premium in return for a sharing of a portion of the risk with another insurer, is not subject to taxation unless the original insurer fails to pay the premiums tax. The fiscal effect of this exemption for domestic companies is included in the exemption from taxation for domestic fire, marine, and casualty companies; for foreign companies, it is included in the estimate for the "reciprocity" statute.

### **Exemptions from the Domestic Life Insurance Company Gross Income Tax Base**

The tax base for domestic (Wisconsin organized) life insurance companies (which may affect only those companies with \$750 million or less of insurance in force) is gross income from all sources, except:

1. interest required to provide and maintain reserves according to the laws of Wisconsin, and
2. premiums collected on policies of insurance and contracts for annuities.

The gross income, net of the above deductions, is subject to a factor with the numerator being net investment income applicable to life insurance and annuities and the denominator being total net investment income.

### **Exemptions from the Foreign and Domestic Life Insurance Company Gross Premium Tax Base**

The tax base for foreign life insurance companies, which is also applicable to domestic life insurance companies having more than \$750 million of insurance in force and may affect those with \$750 million or less of insurance in force, is gross premiums on all policies or contracts of insurance on the lives of residents of Wisconsin less all sums apportioned to premium-paying policies on the lives of residents of Wisconsin from annual distributions of profits, savings, earnings or surplus that have been either paid in cash or applied in partial payment of premiums. Because of long-standing administrative construction,

considerations received for annuity contracts are not considered premiums on policies or contracts of insurance and, thus, are not taxable under section 76.65 (2), Wis. Stats. The fiscal effect shown is that for domestic insurers; the fiscal effect for foreign companies is included in the estimate for the "reciprocity" statute.

## **SPECIAL TREATMENT**

### **Limit on Gross Income Tax of Domestic Life Insurance Companies with \$750 Million or Less of Insurance in Force**

For domestic life insurance companies with \$750 million or less of insurance in force, the tax based on 3.5% of gross income (less deductions) cannot exceed the annual license fee that would have been payable had it been operating as a foreign company (in which case the tax would be 2% of gross premiums, after deducting the preceding tax exemption device). This limit had no fiscal effect in FY06.

### **"Retaliatory" Statute**

The Wisconsin "retaliatory" statute may result in an increase in Wisconsin fees, thus it might not be considered a tax exemption device. However, to the extent that the statutes of other states provide tax exemption devices for insurance companies organized in Wisconsin doing business in such states, the Wisconsin "retaliatory" statute could also allow such tax exemption devices to insurance companies doing business in Wisconsin. The fiscal effect of these other states' statutes are included in the estimate for the "reciprocity" statute.

### **"Reciprocity" Statute**

To the extent that insurance companies organized in Wisconsin operating in the United States outside Wisconsin are subject to taxation to a lesser extent than otherwise provided by Wisconsin law, the Wisconsin "reciprocity" statute may provide reduced taxation for non-Wisconsin companies organized in the United States for business transacted in Wisconsin. The limitations of the "reciprocity" statute are described in the introduction.

## **CREDITS**

### **Credit to Domestic Life Insurers for Personal Property Taxes**

Domestic life insurance companies are allowed a premiums tax credit of 50% of general property taxes paid on personal property in Wisconsin used in the operation of business and not held primarily for investment purposes. The credit is limited to 25% of the license fee for domestic life insurers.

### **Credit to Insurers to Recoup Security Fund Assessments**

The Insurance Security Fund Board administers the security fund established by Chapter 646, Wis. Stats., to provide a mechanism for protecting insureds in the event of liquidation of insurers and to assess the costs of such protection among insurers. Section 646.51 (7), Wis. Stats., provides for tax credits of 20% of security fund assessments in each of the five calendar years following the year the assessment was paid when premium rates are fixed so that it is not possible for the insurer to increase its premium rates to recoup the assessment. Domestic insurers may take tax credits only for the proportion of their business assessed which is fixed, such that it is impossible to raise premiums. Such policies are referred to as "noncancellable" in the insurance business and represent a small portion of the total insurance written. Nondomestic insurers may take tax credits subject to the provision of the retaliatory and reciprocal statutes (sections 76.66 and 76.67, Wis. Stats.)

### **Credit to Insurers for Certified Capital Investment**

Since FY99 certain insurers operating in Wisconsin are allowed to take a premium tax credit for investment in certified capital companies as defined in s. 560.30 Wis. Stats. The purpose of the credit is to encourage insurers to make venture capital for companies operating in Wisconsin. Section 76.635 (2) Wis. Stats. provides for tax credits of up to 10% of the amount of the certified investment each year, until the entire available credit is used.



**Health Insurance Risk-Sharing Plan Assessments Credit**

An income and franchise tax credit and a license fee credit are available for insurers that pay assessments for the Health Insurance Risk-Sharing Plan (HIRSP). HIRSP offers health insurance coverage to individuals with adverse medical histories and to others who cannot obtain affordable health insurance coverage from the private sector. HIRSP is funded by premiums paid by participants, assessments paid by insurance companies, and a pro rata reduction in billed charges of health care providers. The amount of the credit for all insurers cannot exceed \$5,000,000 per year. The credits apply to taxable years beginning after December 31, 2005, but the credits for the 2006 and 2007 tax years may not be claimed until taxable years beginning after December 31, 2007.

## PROPERTY TAX

Local governments, including municipalities, counties, school districts, technical college districts and special districts, levy a tax on most real property (land and improvements) and selected types of personal property in the state. In addition, the state levies a forestry tax, the proceeds of which are deposited to the state conservation fund.

The property tax is the largest source of state and local tax revenues in Wisconsin. In 2006, \$8.3 billion of property taxes were collected in the state as follows: \$3.6 billion by school districts, \$2.0 billion by municipalities, \$1.7 billion by counties, \$0.6 billion by technical colleges and \$0.4 billion by all other taxing jurisdictions (including tax incremental financing districts, special districts and the state forestry tax).

Property tax rates are commonly expressed in terms of dollars per \$1,000 of property value, which is referred to as the mill rate. For taxes levied in 2005 and collected in 2006, the statewide average net tax rate was 18.361 mills (1.8361%) after consideration of the \$469.3 million of property taxes paid by the state through the school levies credit. The total taxable value of property upon which the 2005/2006 levy was imposed was \$428 billion.

Owners of several kinds of exempt real property are required to report to the municipality in which the property is located an estimated fair market value of the exempt property as of January 1 of each even-numbered year. Municipalities submit these reports to the Department of Revenue, which tabulates the data and estimates the total value of tax exempt real property by category of owner.

While the estimated value of certain real property is to be reported, owners of most exempt personal property, ranging from household furnishings and crops to certain housing authorities, cemeteries, and archaeological sites, are not required to file annual reports. In addition, legislation enacted in 1996 repealed the reporting requirement for the state, municipalities, school districts, and certain special purpose districts. Also, the value of federal property is not reported. Thus, the report focuses on exempt private real property.

### Real Property Tax Exemption Value Data

The "Taxation District Exemption Summary Report" on page 78 summarizes data for the municipalities that filed reports with the Department of Revenue by December 1, 2006. Of the total 1,908 taxation districts, 248 had not filed as of that date.

To estimate total values for each category of property, the number of parcels in each value cell for a category is multiplied by the midpoint of the range of values for that cell, and the results summed. Thus, for the "place of worship" classification, the 142 parcels in the \$1 to \$10,000 range multiplied by \$5,000 is added to the 974 parcels in the \$10,001 to \$100,000 range multiplied by \$55,000, and so on for each value category and each classification. Based on this aggregation, the value of the 19,483 exempt parcels in the summary report is \$21.5 billion.

An adjustment was made for the 248 municipalities that had not filed. First, the total taxable value of the towns among the 248 non-filers was determined. This value was multiplied by 1.76%, which is the percent of total taxable property reported by the filing towns to be exempt. Similar computations were made for the villages and cities among the non-filers. The average exemption rate for villages was 4.48% and for cities it was 8.37%. Based on this approach, the value of exempt real property in the non-filing municipalities was added to the \$21.5 billion for the municipalities that filed, producing a total of nearly \$22.5 billion.

Table 1 shows the percentage of total exempt property by purpose for 2006, and the estimated value of that property. The percentages, which are based on the reports filed by taxation districts, are used to allocate the estimated \$22.5 billion in exempt property by purpose.

Table 1 shows that, of the estimated \$22.5 billion of exempt private property, "place of worship" is the largest category with 32.9% of the total, or about \$7.4 billion of exempt property. "Non-profit hospitals" is the second largest category with 11.9%, or about \$2.7 billion of exempt property. "Public benefit" is the third largest category with 10.3% or \$2.3 billion of exempt property. This category includes the properties owned by YMCAs, YWCAs, Scouts and similar organizations. "Grades K-12" and "Private Colleges" comprise 7.5% and 6.7% respectively of exempt property, equal to a combined \$3.2 billion of exempt property value.

TABLE 1  
ESTIMATED VALUE OF EXEMPT PRIVATE REAL PROPERTY, 2006

Purpose of Property	Percent Total	Exempt Value (\$ Million)
<b>RELIGIOUS:</b>		
Place of worship	32.8%	\$7,365
Church - Other	4.3%	\$962
SUBTOTAL	37.1%	\$8,327
<b>EDUCATIONAL:</b>		
Grades K-12	7.5%	\$1,695
Private College	6.7%	\$1,508
Educational - Other	3.2%	\$710
SUBTOTAL	17.4%	\$3,913
<b>MEDICAL FACILITY:</b>		
Non-profit Hospital, incl religious	11.9%	\$2,682
Medical Research Foundation	0.1%	\$18
Medical - Other	2.5%	\$563
SUBTOTAL	14.5%	\$3,263
<b>HOUSING:</b>		
Nursing Home, inc. religious	4.4%	\$997
Retirement Home, inc. religious	4.3%	\$976
Housing - Other	6.6%	\$1,488
SUBTOTAL	15.4%	\$3,461
<b>PUBLIC BENEFIT</b>	10.3%	\$2,310
<b>OTHER</b>	5.3%	\$1,180
<b>TOTAL</b>	100%	\$22,454

### Personal Property

Most personal property, such as household furniture and furnishings, machinery and equipment used in manufacturing, computer equipment, pollution abatement equipment and inventories are exempt from the property tax. This section estimates the value of selected categories of personal property owned by businesses.

*Machinery and equipment used in manufacturing.* The exemption of machinery and equipment used in manufacturing greatly reduces the property tax burden on manufacturers. In 2006, \$1.34 billion of manufacturing machinery and equipment was taxable. Assuming that 10% of all manufacturing machinery and equipment is taxable, approximately \$12.0 billion of machinery and equipment is currently exempt from tax.

*Waste Treatment Facilities.* Certain facilities used to treat wastes are exempt from general property taxation. A waste treatment facility is property used for the treatment of industrial waste materials, including particulates, gas, solids, liquids and other superfluous products. Qualifying facilities must remove, alter or store waste materials. The exemption is available to utilities, manufacturers and commercial businesses. The Department estimates that approximately \$2.5 billion of manufacturing and commercial waste treatment property is exempted. An estimate of the amount of utility waste treatment property that is exempted is not available.

*Computer Equipment.* Wisconsin provides property tax exemptions for certain computer equipment. Exempt from tax are: mainframe computers, minicomputers, personal computers, networked personal computers, servers, terminals, monitors, disk drives, electronic peripheral equipment, tape drives, printers, basic operational programs, systems software, prewritten software, faxes and cash registers. The exemption does not apply to copiers, custom software, equipment embedded with computerized components or telephone

systems. Special payments are made to affected local governments to compensate for the lost tax base. In 2005, approximately \$3.2 billion in computer equipment was exempted, and the corresponding computer aid payments paid in fiscal year 2006 totaled \$67.7 million.

For these three personal property exemptions for which the Department has information to make an estimate, the total exempt value is \$17.7 billion.

### Effect of Exempt Property on Tax Rates

Table 2 examines the extent to which property tax rates could be reduced if the exempt property whose value is estimated in this report were subject to tax. The table shows the estimated 2006 average net property tax rates for towns, villages, cities, and statewide, as well as tax rates calculated under the assumption that the estimated \$22.5 billion of exempt private real property and \$17.7 billion of exempt personal property are added to the tax rolls. The analysis assumes that there would be no change in the overall level of state and federal aids and no change in total property tax levies.

Table 2 indicates that, if the reported exempt private real and personal property had been placed on the tax roll in 2005/06, the statewide average net property tax rate would have declined by 8.6% from \$18.36 to \$16.79 per \$1,000 of value. Under this scenario, total net tax rates in cities, villages, and towns would have been lower by 12.6%, 8.6%, and 3.2%, respectively. The larger impact in cities and villages reflects the fact that exempt property – schools, hospitals, public housing – is more likely to be located in urban than in rural areas.

TABLE 2  
AVERAGE NET TAX RATES FOR 2005, COLLECTED IN 2006 (PER \$1,000 VALUE)

For Property in:	Actual Effective Rate (\$)	Rate if Exempt Private Real and Personal Property Were Taxable	Percentage Change (%)
Cities	\$20.90	\$18.28	-12.6%
Villages	18.61	17.01	-8.6%
Towns	15.14	14.67	-3.2%
Statewide Average	18.36	16.79	-8.6%

### Evaluation

There are several limitations to the estimates provided in this chapter. First, the reported data are incomplete because reports from 248 taxation districts, which include 190 towns, 46 villages and 12 cities, had not been received by the time the report was prepared, and the value of exempt property in these districts had to be estimated. In addition, because the value is reported in ranges, our use of a midpoint could be over or underestimating the true average value of the exempt properties even for those who did report. Also, the value of exempt machinery and equipment had to be estimated. In addition, the value of exempt federal, state, and local government property is not included in this report.

Second, there may be systematic underestimation of exempt property values reported for at least two reasons: (1) a lack of knowledge of the value of often highly-specialized property, which has not been on the market in many years and which is not likely to be offered for sale in the foreseeable future, and (2) a desire to minimize the perceived benefit of the tax exemption for political reasons. However, the data were not audited and, therefore, underestimation cannot be confirmed.

Due to the limitations of these data, care should be taken in using them to represent exempt property values. Care should also be taken in comparing these data to prior years' reports due to the changes in 1996 in reporting requirements and reporting forms.

**TAXATION DISTRICT EXEMPTION SUMMARY REPORT FOR 2006 (S. 70.337(2), Wis. Stats.)**

See instructions on bottom of form.

\_\_\_\_ CO      \_\_\_\_\_ MUN      FOR \_\_\_\_\_ T-V-C      OF \_\_\_\_\_ NAME OF TAXATION DISTRICT      ,      \_\_\_\_\_ NAME OF COUNTY

INDICATE NUMBER OF PROPERTIES BY PURPOSE OF PROPERTY WITHIN EACH VALUE CATEGORY											
	1	2	3	4	5	6	7	8	9	10	Total No. of Properties
PURPOSE OF PROPERTY	\$1-\$10,000	\$10,001-\$100,000	\$100,001-\$200,000	\$200,001-\$500,000	\$500,001-\$1,000,000	\$1,000,001-\$3,000,000	\$3,000,001-\$6,000,000	\$6,000,001-\$12,000,000	\$12,000,001-\$25,000,000	Over \$25,000,000	
WORSHIP	142	974	897	1,260	977	1125	298	71	18	28	5,790
CHURCH-OTH	540	1,049	439	248	92	98	42	11	4	2	2,525
EDU, K-12	38	129	110	99	105	145	53	33	14	10	736
COLLEGE	21	102	71	52	25	41	42	24	12	17	407
EDU-OTH	45	154	82	122	75	53	28	8	3	5	575
HOSPITAL	31	140	22	17	17	29	18	19	36	39	368
MED RSCH	0	0	0	0	2	1	1	1	0	0	5
MED-OTH	26	107	28	30	30	23	14	7	11	3	279
NURSING	9	14	5	9	12	35	26	31	17	4	162
RETIRE	7	32	123	48	29	51	42	18	12	5	367
HOUSE-OTH	39	950	995	406	143	146	41	14	7	6	2,747
BENEFIT	548	1043	423	391	187	205	68	25	8	18	2,916
OTHER	866	902	316	251	128	87	24	19	6	7	2,606
<b>TOTAL NO. OF PROPERTIES</b>	<b>2,312</b>	<b>5,596</b>	<b>3,511</b>	<b>2,933</b>	<b>1,822</b>	<b>2,039</b>	<b>697</b>	<b>281</b>	<b>148</b>	<b>144</b>	<b>19,483</b>

NAME OF CLERK (please print)	TELEPHONE NUMBER (    )
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**INSTRUCTIONS**

Enter the number of exempt properties in your municipality in each value range by purpose or use of property. You can gather this information from the PC-220 forms which are filed by the property owner. A parcel with more than 1 building and more than 1 use should be recorded for each use. Example: For a parcel with a church valued at \$500,000 and a parsonage valued at \$150,000 enter 1 property in the 1<sup>st</sup> value category under WORSHIP and enter 1 property in the 11<sup>th</sup> value category under HOUSE-OTH.

Enter the total number of properties by organization category in the right hand column.

Enter the total number of properties within each value range in the total line at the bottom.

Enter the name and telephone number of the person completing this form.

P-C 226 (R. 7-01)

Note: You should send form PC-227 to organizations reporting to be subject to taxation under sections 511 to 515 of the IRC (see s. 70.339, Wis. Stats.).

Complete and mail this form by July 1 to:

Wisconsin Department of Revenue  
Bureau of Local Financial Assistance  
P. O. Box 8933  
Madison, WI 53708-8933

## FOREST CROP AND MANAGED FOREST LAWS

The Forest Crop and Managed Forest Laws extend special property tax treatment to owners of qualifying forest land. The Forest Crop Law was enacted in 1927 as a means of promoting private forestry in the state. The law was closed to new entrants when the Managed Forest Law went into effect in 1986.

### Historical Background

At one time, Wisconsin was a major timber producer. However, by the early 1920s, much of the state's forest land had been cut-over and/or damaged by fire. Since these lands generated little or no income, owners became unable or unwilling to pay their property taxes. In addition, since these lands were often unsuitable for other uses, counties were unable to sell the land at tax sales, obliging them to assume ownership. Increasing amounts of county-owned, and thus tax exempt, land shifted ever increasing amounts of taxes onto other property owners. This created a fiscal crisis for many local governments.

While farmers pay their annual taxes from the net proceeds of annual crops, forest land owners pay their annual taxes even though their crop may only be harvested after many years. It was thought that reducing the annual tax burden on forest land owners would prevent further land abandonment and, perhaps, encourage reforestation. Local governments, however, were unwilling to forgo the taxes they collected on forest land.

The solution was an amendment to the uniformity in taxation clause of the state constitution which created an exception for forest land. The amendment was approved in 1927. Later that year, the Forest Crop Law (FCL) was enacted, under which land owners paid a flat, annual fee per acre and a severance tax when timber is harvested. A similar program for owners of small forest plots, the Woodland Tax Law (WTL), was enacted in 1954. The Managed Forest Law (MFL) program was enacted in 1985 to replace the FCL and WTL.

### Provisions of the Forest Crop Law (FCL)

Under the FCL, an owner of a complete quarter-quarter section (typically 40 acres) in a town or village could petition the Department of Natural Resources (DNR) to enroll that land in the program. If the DNR determined that forestry was the best use for the land and that a stand of merchantable timber would be produced within a reasonable period of time, the land was entered under the program. Enrollment contracts were for 25 or 50 years, at the landowner's option. The owner was required to practice forestry, to notify the DNR of timber harvests, to allow state appraisals of harvested products, and to permit public access for hunting and recreation. FCL land is exempt from property taxes. In lieu of taxes, owners must make an annual "acreage share" payment to the town or village. Owners are also required to pay a severance tax to the DNR equal to 10% of the value of any forest products that are harvested. Certain penalties can also be imposed if the owner fails to comply with the contract or if the owner withdraws the land from the program before expiration of the contract.

1. **Acreage Share.** This payment is made by the owner to the municipality where the land is located. The municipality retains 80% and remits 20% to the county. On land entered prior to 1972 the payment is \$0.10 per acre. On "special provision" land (entered from 1949 to 1963 and outside DNR fire control boundaries) the payment is \$0.20 per acre. On land entered since 1972, the payment for 2004 to 2013 is \$1.66 per acre, computed as \$0.20 times the following ratio:

$$\frac{\text{Aggregate Land Value in the State in 2002} = \$87,508,935,500}{\text{Aggregate Land Value in the State in 1972} = \$10,544,826,600} = 8.2988$$

This rate is recalculated every 10 years. The next recalculation will be made in 2012.

2. **State Contribution.** Annually, the DNR pays \$0.20 per acre to the municipality where FCL land is located. The municipality keeps 80% of this payment and shares 20% with the county.
3. **Severance Tax.** Every year, the DNR establishes values for the various types of timber harvested across the state. These values are used to calculate the value of timber harvested from FCL land. The severance tax is 10% of the value of the timber harvested, except that no severance taxes are assessed on "special provision" lands. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% of the payment and shares 20% with the county.

4. **Withdrawal Tax.** Land can be withdrawn from the FCL program at the owner's option or, if the owner violates the contract, by DNR order. Either way, a withdrawal tax must be paid. This tax equals the sum, for the years the contract was in effect, of the differences between the amount of real estate taxes that would have been levied on the land and the acreage shares and severance taxes actually paid. Each year's difference is also subject to simple (not compound) interest at 12% per year (5% for pre-1977 contracts) for each year the real estate tax has been deferred. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% and shares 20% with the county.
5. **Termination Tax.** When a contract expires and the land is not enrolled under the MFL program, a termination tax of 10% of the value of the standing timber is assessed. From the proceeds, the DNR keeps an amount equal to the total payments it has made to the municipality on that parcel. Any excess is paid to the municipality, which keeps 80% of the payment and shares 20% with the county.

### **Provisions of the Managed Forest Law (MFL)**

An owner of ten or more contiguous forest acres may apply for entry into the MFL program. As of April 28, 2004, the land can be in any municipality (previously, land in cities could not be enrolled). If the DNR finds that at least 80% of the parcel is actually producing or capable of producing at least 20 cubic feet of merchantable timber per acre per year, and that the land is not developed in a way incompatible with the practice of forestry, the DNR issues an order entering the land under the program. Landowners sign a 25- or 50-year contract. They must follow a forest management plan. In general, they also must permit public access for hunting and recreation. However, landowners can close up to 160 acres to public access (of which no more than 80 acres can be on land for which MFL orders took effect before April 28, 2004) by paying an annual closure fee.

1. **Acreage Share.** For MFL orders that took effect before April 28, 2004, the payment from 2004 to 2008 is \$0.83 per acre, equal to the original payment (\$0.74 per acre) multiplied by the ratio of the average statewide tax per acre on agricultural, swamp and waste, taxable forest land, and other land payable in 2002 divided by the corresponding average for 1986. For MFL orders that took effect on or after April 28, 2004, the payment for 2005 to 2008 will be \$1.46 per acre, equal to the average equalized value per assessed acre of taxable forest land in 2003 (\$1,455) times the net statewide tax rate for 2003/04 (20.0105 mills) times 5%. Both acreage share payments will be recalculated in 2007, with the revised rate effective for payments in 2009. Acreage share payments are made by the owner to the municipality, which keeps 80% and shares 20% with the county.
2. **Closure Fee.** For MFL orders that took effect before April 28, 2004, the payment from 2004 to 2008 is \$1.12 per acre, equal to the original payment (\$1.00 per acre) multiplied by the same ratio used to adjust the acreage share payment. For MFL orders that took effect on or after April 28, 2004, the payment for 2005 to 2008 will be \$5.82 per acre, equal to the average equalized value per assessed acre of taxable forest land in 2003 (\$1,455) times the net statewide tax rate for 2003/04 (20.0105 mills) times 20%. Both closure fee rates will be recalculated in 2007, with the revised rates effective for payments in 2009. The closure fee is in addition to the acreage share payment. The fee is collected by municipalities, which retain none of the proceeds. Through the property tax settlement process, all closure fees are paid to the DNR for deposit in the state Conservation Fund. DNR uses this money in its land acquisition and resource management activities.
3. **State Contribution.** The DNR pays the municipality 20 cents per year for each MFL acre. The municipality keeps 80% and shares 20% with the county.
4. **Yield Tax.** The yield (severance) tax for MFL land is 5% of the value of the merchantable timber cut. Yield taxes are assessed by and collected by the DNR. Except for FCL conversions, for MFL orders that took effect on or after April 28, 2004, the yield tax is waived on harvests in the first 5 years. Beginning on July 1, 2004, DNR remits 100% of any yield taxes to the municipality where the timber was harvested (previously, DNR retained 50% of the yield tax). The municipality keeps 80% of the payment and shares 20% with the county.
5. **Non-compliance Fee.** Effective April 28, 2004, a non-compliance fee of \$250 was established. When DNR determines that an MFL land owner has not complied with the management plan, the municipality is notified. The fee is collected by the municipality where the land is located. The municipality keeps 80% of the fee and

shares 20% with the county.

6. **Withdrawal Fee.** Effective April 28, 2004, the DNR will assess a fee of \$300 on all withdrawals from the MFL program that occur before the expiration of the MFL contract period. DNR retains the entire fee.
7. **Withdrawal Tax.** On withdrawal from the MFL program during an initial order, the land owner must pay the greater of (a) the product of the net assessed value tax rate in the year prior to withdrawal times the assessed value of the land in the year prior to withdrawal times the number of years the land was under an MFL order minus the acreage share and yield taxes paid; or (b) 5% of the stumpage value of the merchantable timber on the land. On withdrawals from the MFL program on renewed MFL orders, the calculation under (a) above is made from the year of the renewal. Beginning on July 1, 2004, DNR remits 100% of any withdrawal taxes to the municipality where the land is located (previously, the DNR retained 50% of the tax). The municipality keeps 80% of the payment and shares 20% with the county.
8. **Contract Expiration.** When a contract expires and is not renewed, the land becomes subject to the property tax.

**Measuring the Tax Reduction under Forest Tax Programs**

In Table 1, the tax that would have been paid on land enrolled under the forest tax laws is termed the "Initial Tax Reduction." It was estimated by (1) multiplying the average net tax per acre on taxable forest land in each municipality by the number of acres enrolled under the forest tax laws in that municipality, and (2) summing these figures across the state for each forest tax law. The amount per acre is the state total under the forest tax law divided by state total acreage enrolled under that program.

TABLE 1  
FINANCIAL ANALYSIS OF FOREST TAX LAWS, 2005/06

Item	Forest Crop Law		Managed Forest Law	
	Amount (\$)	Per Acre	Amount	Per Acre
Initial Tax Reduction	\$ 6,800,318	\$ 20.34	\$ 66,730,630	\$ 23.96
Landowner Payments:				
Acreage shares	239,968	0.72	2,420,587	0.87
Closure fees	0	0.00	2,476,106	0.89
Severance/yield taxes	745,604	2.23	2,524,664	0.91
Termination taxes	195,150	0.58	0	0.00
Withdrawal taxes	659,155	1.97	2,911,343	1.04
Total Landowner Payments	\$ 1,839,877	\$ 5.50	\$ 10,332,700	\$ 3.71
Net Tax Reduction	\$ 4,960,441	\$ 14.84	\$ 56,397,730	\$ 20.25
Acres enrolled	334,362		2,784,888	

The "Initial Tax Reductions" for 2005/06 were \$20.34 per acre under the FCL and \$23.96 per acre under the MFL. Landowner payments (excluding the MFL non-compliance and withdrawal fees, for which data are not available) are subtracted from the "Initial Tax Reduction" to determine the "Net Tax Reduction." As Table 1 shows, the "Net Tax Reductions," or tax savings, in 2005/06 were about \$5.0 million, or \$14.84 per acre under the FCL and about \$56.4 million, or \$20.25 per acre under the MFL. The total net tax reduction under the programs is about \$61.4 million, or about 83% of the total initial tax reduction of about \$73.5 million.

Since their equalized value is zero (due to being tax-exempt), forest tax laws indirectly affect property taxes by shifting part of the tax burden to other property owners and through a redistribution of school equalization aids compared to what the distribution would be if there were no forest tax laws. These effects are not reflected in Table 1 and are not analyzed in this report.

**Evaluation**

The number of privately owned acres enrolled under the various forest tax law programs and the average property tax on taxable forest land for selected years are shown on Table 2.



**TABLE 2**  
**ACRES ENROLLED AND AVERAGE PROPERTY TAX ON FOREST LAND, 1960 - 2005**

Year	Acres Enrolled				Average Property Tax per Acre of Taxable Forest Land
	Woodland Tax Law	Forest Crop Law	Managed Forest Law	Total Acres Enrolled	
1960	60,431	361,211	0	421,642	\$0.52
1965	107,431	490,154	0	597,585	0.56
1970	154,185	643,514	0	797,699	0.87
1975	158,302	951,808	0	1,110,110	1.42
1980	256,349	1,287,833	0	1,544,182	3.31
1985	447,851	1,468,912	0	1,916,763	5.90
1990	472,236	1,452,194	372,102	2,296,532	6.87
1995	302,338	1,406,718	804,269	2,513,325	7.76
2000	55,507	471,727	1,971,474	2,498,708	12.90
2001	0	447,673	2,079,062	2,526,735	15.73
2002	0	428,790	2,231,154	2,659,944	17.96
2003	0	400,716	2,417,023	2,817,739	20.65
2002	0	356,226	2,629,513	2,985,739	23.26
2005	0	334,362	2,784,889	3,119,251	23.53

Sources:

Acreage: 1960-1985: Wisconsin Department of Natural Resources, Forestry Tax Unit. 1990-2005: State totals from Statements of Assessment filed with the Wisconsin Department of Revenue.

Tax per Acre: Calculated by the Wisconsin Department of Revenue for land in the "forest" class.

Although these forest land tax programs have probably increased the amount of timber harvested in the state, the extent to which such harvests can be attributed to the special tax laws is not known. Regardless, property taxes remain a major concern for forest land owners. Increasing demand for forest land for recreational and vacation home uses has led to significant increases in market values for such land. For a forest land owner interested in pursuing forestry, enrolling the land under the MFL is an increasingly attractive way to ease the tax burden. Recent MFL law changes which require enrollees to follow management plans and impose penalties for failure to follow those plans reduces the chances that enrollees will use MFL as a means of reducing taxes while waiting to sell the land for non-forestry purposes.

A considerable portion of the state's privately owned forest land is not enrolled under a forest tax law. Of the approximately 10 million acres of forest land in private ownership, only about 31% is enrolled under the forest tax laws. Some of the 69% non-enrolled land is likely being used to grow a merchantable timber crop. Information is not available to determine why those owners have not enrolled their land under the programs given the substantial reduction in taxes they would obtain by doing so.

## REAL ESTATE TRANSFER FEE

### Introduction

The real estate transfer fee was enacted, effective in 1969, in response to the repeal of the federal stamp tax. It applies to transfers of real estate ownership interests located in Wisconsin.

All real estate conveyances not excluded or exempted by statute are subject to the fee. Payment of the fee is the responsibility of the seller ("grantor") of the property interest. The rate is 30 cents for each \$100 of value or fraction thereof. On conveyances that are gifts or for nominal consideration, value is the estimated price of the property had it been sold on the open market. On other conveyances, value is the full consideration paid for the property plus any liens on the property.

Value data from real estate transfer fee returns are the Department of Revenue's main source of information for determining changes in the fair market value of real property in the state. This information is used in the annual process of determining assessment/sales ratios and equalized values.

### Collections

The fee is payable to the county register of deeds when the deed or instrument of conveyance is recorded. However, the fee for land contracts is due when the land contract is recorded. Completion of a real estate transfer return and payment of the appropriate fee is usually a prerequisite for the register of deeds to record the transaction. Monthly, the county transfers 80% of the fees to the Department of Revenue. The state's share of the fees during FY06 was about \$80.4 million and counties' share was about \$20.1 million.

### Analysis of Exemptions

The primary data source for the value of real estate transfers exempt from the real estate transfer fee consists of fee returns filed with the Department of Revenue in calendar year 2005 on which an exemption was claimed. A fiscal effect is difficult to estimate for some exemptions because a transfer return is not required or there is no consideration for the transfer. The fiscal effects shown below are for the portion of the real estate transfer fee paid to the state. The effect on county revenues is one-fourth of the state fiscal effect.

**TABLE 1  
REAL ESTATE TRANSFER FEE EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference*	FY06 Fiscal Effect
Easements	s. 77.21 (1)	Not available
Leases for less than 99 Years	s. 77.21 (1)	Not available
Conveyances Prior to October 1, 1969	s. 77.25 (1)	\$ 33,000
Conveyances by Government Bodies	s. 77.25 (2)	396,000
Gifts to Governments	s. 77.25 (2g)	32,000
Land Dedications and Highways	s. 77.25 (2r)	1,000
Confirmation, Correction, or Reformation of Prior Conveyances	s. 77.25 (3)	1,951,000
Conveyances for Delinquent Taxes	s. 77.25 (4)	105,000
Conveyances on Partition	s. 77.25 (5)	182,000
Conveyances Pursuant to Certain Business Mergers or Reorganizations	s. 77.25 (6), (6d), (6m)	640,000
Conveyances by Subsidiary Corporation to Parent	s. 77.25 (7)	234,000
Conveyances Between Family Members	s. 77.25 (8) and (8m)	8,907,000
Conveyances Between Agent and Principal	s. 77.25 (9)	1,452,000
Conveyances to Release Debt	s. 77.25 (10)	353,000
Conveyances to Designate TOD Beneficiary	s. 77.25 (10m)	None
Conveyances by Will, Descent, or Survivorship	s. 77.25 (11)	239,000
Conveyances by Nonprobate Transfer on Death	s. 77.25 (11m)	None
Conveyances on Condemnation	s. 77.25 (12)	51,000
Real Estate Valued at \$100 or Less	s. 77.25 (13)	1,000
Conveyances by or in Lieu of Foreclosure	s. 77.25 (14)	1,528,000
Conveyances Between Business Entities and Their Owners	s. 77.25 (15), (15m), and (15s)	4,403,000
Conveyances to Certain Trusts	s. 77.25 (16)	5,990,000
Fulfillment of Land Contract	s. 77.25 (17)	None
Transfers to a Local Exposition District	s. 77.25 (18)	None
Conveyances from a Fiduciary to an Unincorporated Nonprofit Association	s. 77.25 (20)	None
Electric Transmission Facilities and Land Rights	s. 77.25 (21)	None

\*References to sections of the 2005 Wisconsin Statutes.

### **Easements**

Easements are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for easements.

### **Leases for Less than 99 Years**

Leases for less than 99 years are excluded from the definition of conveyances subject to the real estate transfer fee. No real estate transfer fee return is therefore required for leases of less than 99 years.

### **Conveyances Prior to October 1, 1969**

Conveyances made prior to October 1, 1969 (the date the fee went into effect) are exempt from the fee and from filing a transfer fee return. The fiscal effect is therefore understated.

### **Conveyances by Government Bodies and Gifts to Governments**

Conveyances from the United States, the state of Wisconsin or from an instrumentality, agency, or subdivision of either, are exempt from the fee. Such conveyances are also exempt from filing a real estate transfer fee return unless the governmental entity is also a lender for the transaction. Since most sales by government entities are exempt from filing a real estate transfer fee return, the fiscal effect is understated. In addition, conveyances in

the form of gifts to the United States, the state of Wisconsin, or to an instrumentality, agency, or subdivision of either, are exempt from the fee.

### **Land Dedications and Highways**

Conveyances or dedication in a subdivision plat or certified survey for the purpose of a road, street or highway to the United States, the state of Wisconsin or to an instrumentality, agency or subdivision of either are exempt from both the fee and from filing a transfer fee return. Because these transfers are exempt from filing a transfer fee return, the fiscal effect is understated.

### **Confirmation, Correction, or Reformation of Prior Conveyances**

Conveyances that confirm, correct or reform a conveyance previously recorded for nominal, inadequate or no consideration are exempt from the fee.

### **Conveyances for Delinquent Taxes**

Conveyances on sales for delinquent taxes or assessments are exempt from the fee and are also exempt from filing a transfer fee return. Therefore, the fiscal effect is understated.

### **Conveyances on Partition**

Conveyances on partition of real estate that belongs to several persons as co-owners to those persons are exempt from the fee.

### **Conveyances Pursuant to Certain Business Mergers or Reorganizations**

Conveyances pursuant to mergers of corporations are exempt from the fee. For purposes of the real estate transfer fee, mergers of corporations include the combination of two or more corporations, nonstock corporations, limited liability companies, limited partnerships, or any combination thereof. Conveyances pursuant to partnerships reorganizing as limited liability partnerships are exempt from the fee. Conveyances pursuant to conversions of limited partnerships, limited liability companies, business corporations, and non-stock corporations to other forms of business are exempt from the fee if, after the conversion, the ownership interests in the new entity are identical to the ownership interests in the entity immediately preceding the conversion.

### **Conveyances by Subsidiary Corporation to Parent**

Conveyances by a subsidiary corporation to its parent for no consideration, nominal consideration or in sole consideration of cancellation, surrender or transfer of capital stock are exempt from the fee.

### **Conveyances Between Family Members**

Conveyances between husband and wife, parent and child, stepparent and stepchild, parent and son-in-law or parent and daughter-in-law for nominal or no consideration are exempt from the fee.

### **Conveyances Between Agent and Principal**

Conveyances between agent and principal or from a trustee to a beneficiary without actual consideration are exempt from the fee.

### **Conveyances to Release Debt**

Conveyances to provide or release security for a debt or obligation are exempt from the fee. However, for original land contracts filed before August 1, 1992, a transfer fee will be assessed when the documents relating to fulfillment of the land contract are filed.

### **Conveyances by Nonprobate Transfer on Death and to Designate TOD Beneficiaries**

Conveyances of real property that is solely owned, owned by spouses as survivorship marital property, or owned by two or more persons as joint tenants and that is transferred without probate to designated "transfer on death"

beneficiaries are exempt from fee. In addition, conveyances solely to designate a "transfer on death" beneficiary are exempt from fee.

### **Conveyances by Will, Descent, or Survivorship**

Conveyances by will, descent or survivorship are exempt from the fee and exempt from filing a real estate transfer fee return. The fiscal effect is therefore understated.

### **Conveyances on Condemnation**

Conveyances pursuant to or in lieu of condemnation are exempt from the fee.

### **Real Estate Valued at \$100 or Less**

Conveyances of real estate having a value of \$100 or less are exempt from the fee.

### **Conveyances by or in Lieu of Foreclosure**

Conveyances under a foreclosure or a deed in lieu of a foreclosure to a person holding a mortgage or to a seller under a land contract are exempt from the fee.

### **Conveyances Between Business Entities and Their Owners**

Conveyances between a corporation and its shareholders, a partnership and one or more of its partners or a limited liability company (LLC) and its members are exempt if the transfer is for no consideration other than the assumption of debt or stock or other interest in the business entity and all of the stock or other ownership interest is owned by persons who are related to each other as spouses, lineal ascendants or descendants, siblings, or spouses of siblings. Corporations and LLCs are eligible for the exemption only if the business entity has owned the property for at least three years.

### **Conveyances to Certain Trusts**

Conveyances to a trust are exempt if a transfer from the grantor to the beneficiary of the trust would be exempt under other provisions of the real estate transfer fee law (sec. 77.25, Wis. Stats.).

### **Fulfillment of Land Contract**

The recording of deeds in fulfillment of a land contract is exempt from the real estate transfer fee if the proper fee was paid when the land contract was recorded. (The fee on land contracts filed before August 1, 1992, is deferred until the contract is fulfilled. The fee on land contracts filed after July 31, 1992, is due when the contract is filed.) The intent of this provision is to prevent two fees from being imposed on the same land contract transaction. Therefore, this exemption does not reduce state revenues.

### **Transfers to a Local Exposition District**

Transfers of property to a local exposition district organized under Subchapter II of Chapter 229, Wis. Stats., are exempt from the fee.

### **Conveyances from a Fiduciary to an Unincorporated Nonprofit Association**

Conveyances from a fiduciary which held property for the benefit of an unincorporated nonprofit association to the unincorporated nonprofit association in the association's own name are exempt.

### **Electric Transmission Facilities and Land Rights**

Conveyances of transmission facilities or land rights for transmission facilities by a utility company to a transmission company in exchange for securities in the transmission company are exempt from the real estate transfer fee.

## TAXATION OF PUBLIC UTILITIES

### Background

Until the early 1900s, each municipality valued and taxed public utility property located within its borders. In 1905, the state began valuing and taxing railroad property under the "unitary" concept whereby each railroad was valued as a whole, as opposed to separate values in each municipality. In addition, railroad taxes were calculated using the state average tax rate instead of local tax rates. In 1908, street railway companies and associated light, heat, and power companies were brought under state taxation. In 1917, other light, heat, and power companies with property in more than one municipality were brought under this system. Light, heat, and power companies were taxed at local rates until 1929, when the state average rate was applied. This system of taxation was extended to airlines in 1946 and to pipelines in 1950.

Some utilities are taxed on the basis of their gross receipts instead of their property. Rural electric cooperatives, created in the 1930s, were originally taxed on their property. In 1939, they were switched to a tax based on gross revenues. In 1985, private light, heat, and power companies were switched to a tax based on gross revenues. Telephone companies were taxed on their gross revenues until 1998, when they began a switchover, completed in 2000, to a property tax.

Special rules apply to a utility whose property is located in a single municipality. A utility whose primary business is the retail sale of electricity and which has all of its property and customers in one municipality is taxed locally under the general property tax. A utility whose primary business is the wholesale sale of electricity is taxed locally under the property tax if its generating capacity is less than 50 megawatts and taxed under the state gross revenues tax if its generating capacity is 50 megawatts or more.

Total state utility tax collections in FY06 were \$296 million. Taxes on railroads and airlines were deposited in the transportation fund; other utility tax collections, totaling \$275 million, were general purpose revenues and accounted for 2.3% of GPR taxes. Table 1 shows utility tax collections in FY06 for gross revenues and ad valorem taxpayers.

**TABLE 1  
FY06 UTILITY TAX COLLECTIONS**

Utility by Type of Tax	Collections
<b>Gross Revenues</b>	
Carlines	\$ 279,758
Electric Cooperative Associations	8,105,591
Municipal Light, Heat, and Power	2,439,336
Private Light, Heat, and Power	189,063,268
<b>Ad Valorem - Unit Value</b>	
Airlines	4,715,171
Conservation and Regulation Companies	87,985
Municipal Electric Association Projects	1,504,469
Pipelines	10,654,789
Railroads	16,448,600
<b>Ad Valorem – Tangible Property Value</b>	
Telephone Companies	62,996,656
<b>TOTAL</b>	<b>\$296,295,623</b>

### Taxation Methods

Under the gross revenues tax, a company's tax liability is its gross revenues allocated to Wisconsin multiplied by a specified tax rate. Carlines are taxed at 3% of their gross revenues. Rural electric cooperatives are taxed at 3.19% of their retail gross revenues. Private light, heat, and power companies are taxed at 0.97% of their revenues from gas services and 3.19% of their retail gross revenues from electric and other services (primarily steam and water). For rural electric cooperatives and private light, heat, and power companies, the tax rate on gross revenues from wholesale electric sales from 2004 to 2009 will be 1.59%.

Under the ad valorem tax, utilities other than telephone companies are taxed on the basis of the portion of their unit value allocated to Wisconsin. This method is applied to railroads, airlines, pipelines, and conservation and regulation companies. Municipal electric association projects (power systems owned by two or more municipal light, heat, and power companies) make an in-lieu of tax payment based on this method. The utility's value allocated to Wisconsin is multiplied by the net statewide average tax rate to determine the utility's tax liability. The net statewide average tax rate is calculated by dividing the total statewide property taxes levy minus the school levies credit by the statewide full market value of taxable property.

Under the telephone property tax, the real and tangible personal property of each telephone company in each municipality is taxed at the prior year's net tax rate applicable in that municipality.

**TABLE 2  
PUBLIC UTILITIES TAX EXEMPTION DEVICES SUMMARY**

Exemption Device	Statutory Reference *	FY06 Fiscal Effect
<b>Gross Revenues Exemptions</b>		
Power Purchased by Private Light, Heat, and Power Companies	s. 76.28 (1) (d)	\$ 1,896,000
Power Purchased by Electric Cooperatives	s. 76.48 (1g) (d)	5,228,000
Public Benefits Charges	ss. 76.28 (1) (d) and 76.48 (1g) (d)	22,000
Transmission Company Revenues from Wisconsin-taxed Utilities	s. 76.28 (1) (d)	7,313,000
<b>Ad Valorem Exemptions</b>		
Hub Airlines	s. 70.11 (42)	Not available
Motor Vehicles – Generally	s. 76.025 (1)	230,000
Motor Vehicles – Telephone Companies	s. 76.81	Not available
Treatment Plant and Pollution Abatement Equipment – Generally	s. 76.025 (1)	256,000
Treatment Plant and Pollution Abatement Equipment – Telephone Companies	s. 76.81	0
Computers – Generally	s. 76.025 (1)	133,000
Computers – Telephone Companies	s. 76.81	1,200,000
Fax Machines and Cash Registers – Generally	s. 76.025 (1)	Not available
Fax Machines and Cash Registers – Telephone Companies	s. 76.81	Minimal
Telephone Company Property Used Less Than 50% for Telephone Purposes	ss. 70.112 (4) (b) and 76.81	Minimal

\* References are to the 2005 Wisconsin Statutes.

## GROSS REVENUES EXEMPTIONS

### Power Purchased by Private Light, Heat, and Power Companies

Private light, heat, and power companies may deduct from their gross revenues tax base an amount equal to the following percentages of their cost of power purchased for resale:

- 100% if:
  - the company purchased more than 50% of the power it sells, and
  - the power was not purchased from a company with an "affiliated interest" (i.e., neither company may have an ownership interest in the other), and
  - the revenue from the purchased power was included in the seller's gross revenue as reported to the Wisconsin Public Service Commission (i.e., the seller is subject to Wisconsin's gross revenues tax).
- 50% if:
  - the company purchases more than 90% of its power, and
  - the company has less than \$50 million of gross revenues.

### **Power Purchased by Electric Cooperatives**

Electric cooperatives may deduct from their gross revenues the cost of power purchased for resale if the cooperative meets one of the following tests:

- The cooperative purchases more than 50% of the power it sells, and the revenue from the purchased power is included in the seller's gross revenues, or
- The cooperative purchased more than 50% of the power it sold in 1987 from a seller located outside Wisconsin.

### **Public Benefits Charges**

Beginning in September 2000, private light, heat, and power companies' responsibilities for providing public benefits programs such as low-income energy assistance, energy conservation, and renewable energy assistance programs were transferred to the state. Funding for these programs is provided by a state-mandated public benefits charge on monthly utility bills. Utility companies remit the fees collected to the state. These public benefits charges are excluded from the revenues subject to the gross revenues tax. Since the fee is paid to the state, there is no state revenue loss.

Electric cooperatives and municipal electric companies can participate in the state program or operate their own public benefits programs. In either case, the programs are funded by a state-mandated public benefits charge on monthly utility bills. These public benefits charges are excluded from the revenues subject to the gross revenues tax. If the entity participates in the state program, fee collections are remitted to the state and there is no state revenue loss. If the entity operates its own program, there is a state revenue loss equal to the amount of the public benefits charge times the tax rate applicable to the utility service.

### **Transmission Company Revenues from Wisconsin-taxed Utilities**

When calculating its gross revenues, a transmission company may exclude revenues for services provided to: (1) electric cooperatives organized under Wisconsin law that provide wholesale service to their members, (2) municipal light, heat, and power companies based in Wisconsin, and (3) private light, heat, and power companies which are subject to the state's gross revenues tax.

## **AD VALOREM EXEMPTIONS**

### **Hub Airlines**

2001 Wisconsin Act 16 exempted property of a "hub airline" from the state ad valorem tax on airlines and from local property taxes. An airline qualified as a "hub airline" if in the prior year it (1) operated at least 45 common carrier flights each weekday to at least 15 non-stop destinations from a single airport in Wisconsin; or (2) it was headquartered in Wisconsin and operated, from single airport or combination of Wisconsin airports, at least 20 common carrier flights each weekday. Since exempt airlines are not required to file financial reports with the Department of Revenue, the data needed to estimate the effect of this exemption are not available.

### **Motor Vehicles – Generally**

Motor vehicles such as automobiles, trucks, and trailers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem utility tax but subject to registration fees in the same manner as other motor vehicles.

### **Motor Vehicles – Telephone Companies**

Motor vehicles owned by telephone companies are exempt from the telephone property tax but subject to registration fees in the same manner as other motor vehicles. Since telephone companies do not report the value, number, or type of motor vehicles, an estimate of the revenue loss under this exemption is not available.



**Treatment Plant and Pollution Abatement Equipment – Generally**

Property owned by airline, pipeline, railroad, or conservation and regulation companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the ad valorem utility tax.

**Treatment Plant and Pollution Abatement Equipment – Telephone Companies**

Property owned by telephone companies used as a waste treatment facility to abate or eliminate the pollution of the water or air of the state is exempt from the telephone property tax. Telephone companies did not own any such property in FY06.

**Computers – Generally**

Computers owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from the ad valorem tax. The exemption may be slightly overstated since those fax machines and cash registers which are also exempt are generally included in the schedules for computers when reported to the Department of Revenue.

**Computers – Telephone Companies**

Telephone company computers, operating system software, and prewritten software that are used for general business purposes are exempt from the telephone property tax.

**Fax Machines and Cash Registers – Generally**

Cash registers and fax machines, excluding fax machines that are also copiers, owned by airline, pipeline, railroad, or conservation and regulation companies are exempt from taxation. This equipment is not separately reported, but is generally included with computers on utility reports filed with the Department. An estimate of the effect of this exemption is therefore not available.

**Fax Machines and Cash Registers – Telephone Companies**

Cash registers and fax machines, excluding fax machines that are also copiers, owned by a telephone company are exempt from taxation. This exemption had an insignificant effect on revenues for FY06.

**Telephone Company Property Used Less Than 50% for Telephone Purposes**

Property that is used less than 50% in the operation of a telephone company is exempt from the telephone property tax. Instead, such property is subject to local property taxes. This exemption had an insignificant effect on state revenues for FY06.