

EXPLANATIONS OF TAX PROVISIONS IN 1983-85 BUDGET BILL (1983 WISCONSIN ACT 27)

A. INCOME TAXES

1. Update Internal Revenue Code Reference for 1983 Tax Year (Amend s. 71.02(2)(b)8, create 71.02(2)(b)9 and 71.05(1)(a)17 and 23, effective for 1983 tax year and thereafter.)

For the 1983 tax year and thereafter, individuals, estates and trusts will use the Internal Revenue Code in effect on December 31, 1982 with the following exceptions:

- (a) The following Internal Revenue Code provisions which were in effect on December 31, 1982 will not apply for Wisconsin purposes:
- (1) The deduction from gross income allowed two-earner married couples. (For federal purposes this deduction is equal to 10% of the lower-earning spouse's income for 1983 and thereafter, with a maximum of \$30,000 of earned income allowed to be used to compute the deduction.) This deduction is allowed under Section 221 of the Internal Revenue Code.
  - (2) The exclusion from income allowed for public utility dividends which are reinvested in the common stock of the utility as provided under Section 305(e) of the Internal Revenue Code.
  - (3) Charitable contribution deductions allowed to persons who do not claim itemized deductions. This deduction is allowed under Section 170 (i) of the Internal Revenue Code.
  - (4) The exclusion from income allowed for interest received from an "All-Savers" certificate as provided under Section 128 of the Internal Revenue Code.
  - (5) The incentive stock option provisions as provided under Section 422A of the Internal Revenue Code.
  - (6) The partial exclusion of interest income which will be allowed for federal purposes beginning in tax year 1985 under Section 128 of the Internal Revenue Code, as amended by Section 302(a) and (c) of Public Law 97-34.
- (b) In addition to the above differences, Wisconsin and federal law for 1983 and thereafter will continue to differ with respect to the following items:
- (1) For 1983, child care expenses continue to be allowed as an itemized deduction for Wisconsin purposes. (Note: Beginning in 1984 Wisconsin will have a child care credit which will be equal to 30% of the federal child care credit. See Part A.8 for further details.)
  - (2) Political contributions continue to be allowed as an itemized deduction for Wisconsin purposes.

- (3) The foreign earned income exclusion which was allowed to persons who worked abroad, as provided by the Internal Revenue Code as of December 31, 1977, continues to apply for Wisconsin purposes. (The new foreign earned income exclusion limits and deduction provisions enacted in Sections 111 and 113 of Public Law 97-34 may not be used for Wisconsin purposes.)
- (c) The provisions of the following federal laws enacted during 1983 will apply for Wisconsin purposes:
- (1) Public Law 97-424 which provides for business expense deductions for certain conventions held on cruise ships.
  - (2) Public Law 97-448, the Technical Corrections Act of 1982.
  - (3) Public Law 97-473 which contains provisions relating to: 1) an exclusion for amounts which are received for assuming liability for periodic payments of personal injury damages, 2) an exclusion for amounts received by an individual as "difficult care" payments for a handicapped foster child and 3) Indian tribal governments being treated as a state for purposes of determining if contributions made to the tribal government qualify as an itemized deduction.
  - (4) Public Law 98-4 relating to the income tax treatment for agricultural commodities received under the 1983 payment-in-kind (PIK) program.

(NOTE: A change was also made in the definition of the Internal Revenue Code which applies for the tax year 1982. The provision in federal law which provides an exclusion from income for National Research Service Awards is adopted retroactively for the 1982 tax year and also applies to the 1983 tax year and any subsequent years.)

2. Income Tax Surtax for 1983 and 1984 (Create s. 71.014, 10% surtax effective for 1983 and 1984 tax years.)

An income tax surtax of 10% will be imposed on individuals, estates and trusts for the 1983 and 1984 tax years. The surtax percentage will be multiplied by the gross tax to arrive at the amount of surtax (e.g., gross tax of \$1,000 x 10% equals surtax of \$100).

The surtax will also be imposed on the minimum tax (e.g., minimum tax of \$500 x 10% equals surtax of \$50).

The surtax on the gross income tax will be computed before deducting personal exemptions or any other credits or tax payments.

The 10% surtax is part of the tax for purposes of any underpayment or declaring estimated taxes under s. 71.21. Any declaration of estimated tax payments that would have been due under s. 71.21 before July 1, 1983 solely because of this 10% surtax must be prorated equally among, and paid with, any payments that are due on or after July 1, 1983 for the 1983 tax year.

3. Indexing Income Tax Brackets (Amend s. 71.09(2), effective for 1983 tax year and thereafter.)

The income tax brackets will not be indexed for the 1983, 1984 and 1985 tax years, which means that the income tax brackets in effect for the 1982 tax year will continue in effect for the 1983 through 1985 tax years.

For the 1986 tax year and thereafter, the income tax brackets will be indexed only for the increase in consumer price index (CPI) from June to June that exceeds 3%, with the maximum percentage increase being 7% (e.g., if the CPI increase is 11%, the brackets will be indexed by 7% (11% - 3% = 8%, but maximum increase limited to 7%)). The income tax brackets resulting from indexing will be rounded to the nearest \$10.

The income tax brackets will never be reduced below the brackets in effect for the prior year.

4. Index Standard Deduction (Create s. 71.02(2)(gr), effective for 1986 tax year and thereafter.)

For 1986 tax year and thereafter, the \$2,300 standard deduction for single persons and \$3,400 deduction for married persons in s. 71.02(2)(gq)(2) will be indexed by the same percentage that the income tax brackets are indexed, that is, the CPI increase from June of the previous year to June of the current year, less 3%. The maximum increase would be 7%.

The indexed amounts will be rounded to the nearest \$10.

The standard deduction amounts will never be reduced below the amounts in effect for the prior year.

NOTE: The low-income allowance amounts in s. 71.02(2)(gq)3 will not be indexed.

5. Filing Requirements for Dependents with Unearned Income (Amend s. 71.10(2)(a)5. (intro.), create s. 71.10(2)(a)5.d, repeal s. 71.10(2)(a)5.c, effective for 1983 tax year and thereafter.)

Dependents with unearned income (e.g., interest, dividends) will be required to file a Wisconsin income tax return if their unearned income is \$1,000 or more.

6. Deduction for IRA's--Married Persons With Non-Working Spouse IRA May Divide Total Deduction Between Them (Create s. 71.05(3)(h), effective for 1982 tax year and thereafter.)

When only one spouse works during the taxable year and a contribution is made to the non-working spouse's IRA, a married couple may divide the deduction for the total IRA contributions made between them in any manner they choose. (Note: This law is effective for taxable year 1982 and thereafter, thereby voiding rule Tax 2.945. Amended returns may be filed for 1982 to reflect this change in tax treatment.)

(CAUTION: This change pertains only to married couples who have a non-working spouse IRA. It does not allow spouses to divide IRA deductions between them in situations where both spouses have earned income for the tax year.)

Example: Mr. X has earned income of \$20,000 in 1982 and establishes individual retirement accounts for himself and his non-working spouse, who received \$500 of taxable interest income during 1982. Timely contributions totalling \$2,000 were made to his account and \$250 was contributed to his spouse's account for 1982. Mr. X and Mrs. X may divide the total IRA contribution of \$2,250 between them in any manner they choose (e.g., Mr. X could deduct the entire \$2,250 on his 1982 Wisconsin income tax return).

7. IRA Penalties--33% of Federal Penalties (Create s. 71.11(44m), effective with respect to penalties imposed for federal income tax purposes on or after July 2, 1983.)

Any person who is liable for a penalty under the following sections of the Internal Revenue Code for federal income tax purposes is liable for 33% of the federal penalty for Wisconsin purposes:

- (1) IRC Section 408(f) - 10% penalty for an early distribution from an IRA.
- (2) IRC Section 4973 - 6% tax on excess contributions to an IRA.
- (3) IRC Section 4974 - Excise tax on certain accumulations in an IRA.
- (4) IRC Section 4975 - Tax on prohibited transactions concerning an IRA.

These penalties will be assessed, levied and collected in the same manner as income taxes.

8. Child Care Credit--30% of Federal Credit (Amend s. 71.09(13) (cm), create s. 71.09(12c), effective for tax year 1984 and thereafter.)

Individuals may claim a nonrefundable credit equal to 30% of the federal dependent care credit, prior to adjustments for federal tax credits and federal tax liability, for which they are eligible for the tax year under Section 44A of the Internal Revenue code as amended to December 31, 1982.

Married persons may divide the total amount of the credit between them in any manner they choose. The credit is not available if husband and wife report their income on separate income tax returns.

The credit may be claimed by full-year and part-year residents of Wisconsin for tax years 1984 and thereafter. Part-year residents must reduce their credit by 1/12 for any month in which they do not reside in Wisconsin (15 days or more is considered a month). Nonresidents are not eligible for this credit.

No credit may be allowed unless it is claimed within 4 years of the unextended due date of the Wisconsin income tax return.

The civil and criminal penalties, etc., in s. 71.09(13)(cm) will apply to persons filing a false or fraudulent claim for the child care credit.

9. Property Tax/Rent Credit--Changed from 12% to 10% and Limited to Principal Dwelling (Amend s. 71.53(1)(b), (c) and (2), effective for 1983 tax year and thereafter.)

The property tax credit is 10% of the claimant's property taxes and the rent credit is 10% of rent constituting property taxes (percentage was 12% under prior law).

Also, in computing the property tax credit, only property taxes paid on the claimant's "principal dwelling" may be used to compute the credit. Property taxes on nonbusiness property other than an individual's principal dwelling no longer may be used in computing the credit.

"Principal dwelling" is the dwelling used as the primary residence of the claimant and as much of the land surrounding it as reasonably necessary for use of the dwelling as a primary residence. It may also include a part of a multidwelling or multipurpose building and a part of the land upon which it is built that is used as the primary residence.

10. Research Credit--5% of Qualified Research Expenses (Create s. 71.04(2)(b)5, 71.05(1)(a)16, and 71.09(12r), amend 71.09(13)(cm), effective for 1984 tax year and thereafter.)

This credit may be claimed by individuals, estates, trusts and corporations. Partnerships and tax-option (Sub S) corporations may not claim the credit; however, the individual partners or shareholders may claim the credit that is passed through from the partnership or tax-option corporation. See Part B.6 for an explanation of how to compute the credit.

11. Research Credit--5% of Facility Costs (Create s. 71.04(2)(b)5, 71.05(1)(a)16 and 71.09(12rf), amend 71.09(13)(cm), effective for 1984 tax year and thereafter.)

This credit may be claimed by individuals, estates, trusts and corporations. Partnerships and tax-option (Sub S) corporations may not claim the credit; however, the individual partners or shareholders may claim the credit that is passed through from the partnership or tax-option corporation. See Part B.7 for an explanation of how to compute the credit.

12. Earned Income Credit--30% of Federal Credit (Create s. 71.09(12t), amend 71.09(13)(cm), effective for 1984 tax year and thereafter.)

Any natural person may claim as a credit against Wisconsin income taxes due an amount equal to 30% of the federal earned income credit for which the person is eligible under Section 43 of the December 31, 1982 Internal Revenue Code. (See Part A. 20 which shows the sequence for claiming this credit in relation to other credits and payments.)

Married persons may divide this credit between them in any manner they choose. In order for married persons to claim this credit, they must file a combined Wisconsin income tax return. Part-year residents and nonresidents are not eligible for this credit.

In order for the credit to be allowed, it must be claimed within four years of the unextended due date of the person's individual income tax return. This credit is nonrefundable and may not be carried forward. The civil and criminal penalties, etc., in s. 71.09(13)(cm) will apply to persons filing a false or fraudulent claim for the earned income credit.

13. Basis Difference Subject to Capital Gain/Loss Treatment (Create s. 71.05(5), effective for 1983 tax year and thereafter.)

Sections 71.05(1)(c), (f)(3) and (g), and 71.05(2) and (4) of the Wisconsin Statutes currently require additions to or subtractions from federal adjusted gross income to be made to account for differences existing between the Wisconsin and federal basis of assets which have been sold. The purpose of these adjustments is to provide that the amount of gain or loss included in Wisconsin taxable income reflects the amount which is determined by using the Wisconsin basis of the asset sold.

The creation of s. 71.05(5) states that differences in basis of assets accruing under sections 71.05(1)(c), (f)(3) and (g), 71.05(2) and 71.05(4) (provided the assets qualify for capital gain or loss treatment) will be combined with other long-term or short-term capital gains and losses to determine the amount of capital gain exclusion, capital loss, etc.

Example: Taxpayer sells a capital asset for \$3,000 during 1983. The federal basis of the asset is \$2,000 and the Wisconsin basis is \$1,000. The transaction qualifies for long-term capital gain treatment and is the only capital gain transaction the taxpayer has in 1983. The transaction is reported as follows on a 1983 Wisconsin return:

|               |  |
|---------------|--|
| \$ 400        | Federal AGI starting point (\$1,000 gain, less 60% exclusion)  |
| 200           | Modification per s. 71.05(1)(a)2 (For 1983, 60% of a long-term gain is taxable by Wisconsin)   |
| 600           | Modification for basis difference (Basis difference is \$1,000, but since only 60% of a long-term gain is taxable in 1983, the modification to be made is \$600 (1,000 x 60%)) |
| <u>\$1200</u> | Total gain includible in Wisconsin income.   |

14. Tax Capital Gains of Certain Trusts (Create s. 71.05(1)(a)22, effective for 1983 tax year and thereafter.)

Any amount excluded from adjusted gross income under Section 641(c)(1) of the Internal Revenue Code must be included in Wisconsin income as an add modification under s. 71.05(1)(a)22. (Note: Because of the special federal method of taxing a capital gain realized on the trustee's sale of an asset within two years of receiving it from the donor, the gain is not included in the grantor's federal adjusted gross income; and, is not included in the trust beneficiary's federal adjusted gross income. With this new add modification in s. 71.05(1)(a)22, the recognized gain taxed by this special method under the Internal Revenue Code will now be included in the Wisconsin income of the trust.)

EXAMPLE

An asset is placed in a trust by a living person and the transfer qualifies as a completed gift for Wisconsin gift tax purposes. The asset is sold by the trust within 2 years of receipt of the asset. The sales price, basis and value on date of transfer are as follows:

|                                 |              |
|---------------------------------|--------------|
| Sales price                     | \$100,000.00 |
| Value when placed in the trust  | 97,000.00    |
| Basis of the asset              | 16,000.00    |
| Total gain (\$100,000 - 16,000) | 84,000.00    |

Wisconsin taxable gain computed as follows:

|  | <u>PRIOR TO<br/>1983 TAX YEAR</u> | <u>NEW LAW -1983<br/>TAX YEAR<br/>AND THEREAFTER</u> |
|--|-----------------------------------|--|
| Sales price  | \$100,000                         | \$100,000  |
| Basis  | 16,000                            | 16,000   |
| Total gain   | <u>84,000</u>                     | <u>84,000</u>  |
| Gain excluded from trust<br>taxable income (\$97,000<br>less \$16,000; IRC<br>section 641) | 81,000 *                          | -0-  |
| Wisconsin taxable gain   | <u>\$ 3,000</u>                   | <u>\$ 84,000</u>                                     |

\* In this situation for tax years prior to 1983, \$81,000 of the \$84,000 gain is not being taxed by Wisconsin. This \$81,000 is being taxed for federal purposes.

15. Standard Deduction Allocation for Married Persons if Exceed Allowable Amount (Create s. 71.05(3)(g), effective for 1983 tax year and thereafter.)

If the total standard deduction claimed by husband and wife exceeds the total amount allowable, the Department of Revenue may allocate 50% of the total amount allowable to each spouse. If the 50% amount exceeds the Wisconsin adjusted gross income of one spouse, the Department may allocate the excess amount to the other spouse. The Department's allocation is presumed correct unless the Department receives a written notice signed by both spouses agreeing to a different allocation.

16. Minimum Tax Changes (Amend s. 71.60(1)(c), (d) and (2), effective for 1983 tax year and thereafter.)

For the tax year 1983 and thereafter, the term "Internal Revenue Code" as used in the Wisconsin minimum tax provisions in s. 71.60 will mean the Code in effect on December 31, 1982.

The minimum tax provisions in s. 71.60 are amended to clarify that accelerated depreciation claimed under the accelerated cost recovery system (ACRS) provisions of the Internal Revenue Code for real property and leased personal property is a tax preference item for purposes of

the Wisconsin minimum tax. Section 71.60 had referenced sections 57(a)(2) and (3) of the Internal Revenue Code, which sections provided that all accelerated depreciation on real property and leased personal property constituted a tax preference item. An additional reference to section 57(a)(12) of the Code is included in the Wisconsin minimum tax provisions in s. 71.60 to clarify that ACRS deductions are includable as a tax preference item.

As stated in Part A.2, the 10% surtax which will be in effect for 1983 and 1984 will also be imposed on the minimum tax in those years.

17. Endangered Resources Program--Voluntary Payments on Income Tax Returns  
(Create s. 71.097, effective for 1983 tax year and thereafter.)

An individual filing an income tax return may designate on the return an additional amount for the endangered resources program. For purposes of this provision (s. 71.097) "endangered resources program" means purchasing or improving land or habitats for any native Wisconsin endangered species as defined in s. 29.415(2)(a) or (b) or for any non-game species as defined in 29.01(3)(e), conducting wildlife and resource research and surveys, providing wildlife management services and providing for wildlife damage control or the payment of claims for damage associated with endangered or threatened species and the payment of administrative expenses relating to the administration of this section.

If an individual has tax due on the income tax return, he or she may designate an additional amount for the endangered resources program and shall remit in full the tax due including the designated amount when the individual files a tax return. If the individual owing a tax fails to remit an amount equal to or in excess of the total of the tax due (after any error corrections) and the designated amount:

- (1) The department will reduce the amount designated to the amount by which the remittance exceeds the tax due (after any error corrections).
- (2) If the amount remitted with the return does not exceed the tax due, the designation will be void.

If the individual still has a refund after applying the refund to any delinquency owing the department, pursuant to s. 71.09(10) and any offset provided for under 71.10(10)h, the Department of Revenue will deduct the amount designated for the endangered resources program from the remaining refund.

If the individual designating an amount for the endangered resources program places any conditions on the designation, the designation is void.

18. Add Modification Required if Employer Fails to Provide Certain Health Care Plans (Create s. 71.05(1)(a)21 and 24, effective date same as for corporate employers - see Part B. 12).



An employer will be required to make an addition modification to include in Wisconsin taxable income certain amounts deducted as health care costs in determining federal adjusted gross income. A similar requirement applies to corporations. See Part B.12 for additional details as to the situations in which employers will be denied deductions for health care costs.

19. Adoption Expenses--Excess Over 5% of Federal Income (Amend s. 71.05(1)(b)7, effective for 1983 tax year and thereafter.)

The subtract modification for adoption expenses will be limited to the amount by which such expenses when added to other medical deductions exceed 5% of federal adjusted gross income. For the 1982 tax year the percentage was 3%.

20. Specify Order for Claiming Credits and Payments on Tax Returns (Amend s. 71.09(6p)(intro.), 71.60(2), create s. 71.65, effective for 1983 tax year and thereafter.)

The order for deducting personal exemptions, credits and payments from the tax and surtax on income tax forms will be as follows:

- (a) Tax under s. 71.09(1b)
- \* (b) Surtax under s. 71.014
- (c) Personal Exemptions under s. 71.09(6p) (non-refundable, husband and wife may split)
- (d) Property Tax and Rent Credit under s. 71.53 (non-refundable, husband and wife may split)
- (e) Child Care Credit under s. 71.09(12c) (non-refundable, husband and wife may split)
- \* (f) Earned Income Credit under s. 71.09(12t) (non-refundable, husband and wife may split)
- (g) Minimum Tax including any surtax on minimum tax under s. 71.60
- (h) Credit for Taxes Paid to Other States under s. 71.09(8) (non-refundable)
- \* (i) Research Credit - 5% of Qualified Research Expenses under s. 71.09(12r) (non-refundable, 7 year carry forward)
- \* (j) Research Property Credit - 5% of Facility Costs under s. 71.09(12rf) (non-refundable, 7 year carry forward)
- (k) Community Development Finance Credit under s. 71.09(12m) (non-refundable, unlimited years carry forward)
- (l) Total of Farmland Preservation Credit, Homestead Credit, Estimated Tax Payments and Taxes Withheld under s. 71.09(11), 71.09(7), 71.21, and 71.19, respectively

\* Note: The earned income credit and both research credits will be effective for the 1984 tax year and thereafter, and the surtax will be only for 1983 and 1984 tax years.

Husband and wife must claim their own individual credits and payments unless noted otherwise above.