

*STATE OF WISCONSIN*  
*REPORT OF THE JOINT SURVEY COMMITTEE ON TAX EXEMPTIONS*  
*2009 ASSEMBLY BILL 648*

[Introduced by Representatives Molepske Jr., Dexter, Hilgenberg, Zigmunt, Pasch, Petersen, Turner, Ziegelbauer, Black, Kerkman, Hebl, Steinbrink, Clark, Bernard Schaber, Barca, Staskunas, Roys, Pope-Roberts, Zepnick, Strachota, Lothian, Bies, Fields, Gunderson and Vos, cosponsored by Senators Sullivan, Lassa, Holperin, Wirch, Kreitlow, Lehman, Leibham, Plale, Schultz, Miller, Darling, Vinehout and Taylor.]

**General Nature of Proposal**

*2009 Assembly Bill 648* adopts federal law that allows taxpayers with adjusted gross incomes over \$100,000 to convert a traditional IRA to a Roth IRA, and allows the income tax from the conversion to be paid over two years, beginning with the 2010 tax year.

The bill also adopts the federal Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008, which gives certain military service members exceptions to IRA contribution and withdrawal limitations, health flexible spending account withdrawal limitations, and gross income inclusion requirements.

**Legality Involved**

There are no questions of legality involving the bill described in this report.

**Fiscal Effect Upon the State and Its Subdivisions**

With regard to IRA conversions, the Legislative Fiscal Bureau estimates the fiscal effect of the bill as follows:

**Effect of TIPRA Provisions Related to IRA Conversions.** If Wisconsin does not adopt the TIPRA provisions, taxpayers with incomes over \$100,000 who make conversions would incur penalties. DOR's Wisconsin Tax Bulletin for October, 2009, describes these penalties:

If the person is under age 59½, the person would be subject to an early distribution penalty. The penalty is equal to 3.33% of the amount converted. The person would also be subject to a 2% penalty for an excess contribution to the Roth IRA. This penalty would be applied each year until the excess contribution is withdrawn. Persons age 59½ or over would only be subject to the excess contribution penalty.

At the time of its adoption, the waiver of the \$100,000 income limit was estimated to have a positive effect on federal income tax collections in

federal fiscal years 2011, 2012, and 2013 and a negative impact on revenues in later years. The positive effect is due to the taxes on amounts previously deducted from taxable income when the traditional IRAs were created. The negative effect is due to future withdrawals from Roth IRAs, which are exempt from taxation.

Changes in federal tax policy may induce certain behavioral responses from taxpayers. Wisconsin's 3.33% tax on early distributions and 2% tax on excess contributions will likely cause some taxpayers to refrain from converting their IRAs, although some taxpayers who are unaware of the penalties will make conversions. Therefore, Wisconsin's adoption of the federal conversion treatment would have two offsetting effects. Among taxpayers who will make conversions without regard to Wisconsin's tax treatment, a revenue loss of \$2.1 million is estimated for 2010-11 (penalties of \$1.2 million on early distributions and \$0.9 million on excess contributions). Among taxpayers who will not undertake conversions unless Wisconsin adopts the federal conversion treatment, a revenue increase of \$3.1 million is estimated. The combined effect of adopting the federal treatment is therefore estimated as an additional \$1.0 million in state tax collections in 2010-11. The combined effect on state revenues is estimated at +\$1.5 million for 2011-12 and -\$1.7 million for 2012-13. In future years, this provision would continue to have a negative effect on state revenues because distributions would be made from Roth IRAs on a tax-free basis, rather than from traditional IRAs on a taxable basis.

With regard to the provisions related to the federal HEART Act, the LFB estimates the bill to have a minimal fiscal effect on state revenues.

#### **Public Policy Involved**

The bill is good public policy.

02/16/10

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