

WISCONSIN

TAX OPTIONS

A GUIDE TO FAIR, SIMPLE, PRO-GROWTH REFORM

Katherine Loughead | Jared Walczak | Joseph Bishop-Henchman



**BADGER
INSTITUTE**

Free Markets • Opportunity • Prosperity

WISCONSIN

TAX OPTIONS

A GUIDE TO FAIR, SIMPLE, PRO-GROWTH REFORM

TABLE OF CONTENTS

Introduction	1
Executive Summary	2
Our Objective	4
Menu of Tax Reform Options	5
Improvements Included in All Options	7
Individual Income Tax	7
Corporate Income Tax	7
Sales Tax	7
Key Elements of Wisconsin Tax Reform Options	8
Other Important Considerations	8
CHAPTER 1: Wisconsin's Economy	9
Introduction	10
State Gross Domestic Product (GDP)	10
Personal Income	13
Major Industries	16
Employment	18
Migration Patterns	20
CHAPTER 2 Wisconsin's Tax and Budget Structure	23
Introduction	24
Recent Tax and Spending Policies	24
Measures of State Tax Competitiveness	29
CHAPTER 3: Individual Income Taxes	33
Introduction	34
A Brief History of Wisconsin's Individual Income Tax	34
Wisconsin's Individual Income Tax Collections: Then and Now	35
Comparing Wisconsin's Individual Income Tax Structure to Regional and National Competitors	37
Structural Elements	39
Marriage Penalty	39
Standard Deduction	40
Personal Exemption	41
Itemized Deductions Credit	41
Capital Gains	42
Pass-Through Businesses Pay Individual Income Taxes	42
Individual Income Tax Reform Solutions	44
Individual Income Tax Option A	44
Individual Income Tax Option B	44
Individual Income Tax Option C	45
Individual Income Tax Option D	45
Impact of Individual Income Tax Solutions on Real People	46
CHAPTER 4: Corporate Income Taxes	47
Introduction	48
Overview of Wisconsin's Corporate Income Taxation	48
Comparing Wisconsin's Corporate Taxes Regionally and Nationally	50
Corporate Income Tax Collections	51
Corporate Income Tax Expenditures	52
Structural Elements	54
Net Operating Loss Carrybacks and Carryforwards	54
Apportionment and Throwback	55
Corporate Income Tax Reform Solutions	56
Conform Treatment of Net Operating Losses	56
Eliminate the Throwback Rule	56
Couple to Federal Expensing Rules	56
Lower Corporate Tax Rate	57
Repeal the Economic Development Surcharge	57

CHAPTER 5: State and Local Sales Taxes	59
Introduction	60
History of Wisconsin’s Sales and Use Tax	61
Sales Tax Rate Composition	61
Sales Tax Collections	63
Sales Tax Base Composition	64
Taxation of Goods	64
Taxation of Services	65
Sales Tax Breadth	66
Taxation of Business Inputs	68
Wisconsin’s Sales Tax Holiday is a Base-Narrower	69
Taxation of E-Commerce	69
South Dakota v. Wayfair	70
Wisconsin is Poised to Benefit from the Wayfair Decision	71
Sales Tax Reform Solutions	72
Base-Broadening Options	72
Sales Tax Rates	73
Potential Windfall to Local Governments from Sales Tax Base Expansion	73
Impact of Sales Tax Solutions on Real People	74
CHAPTER 6: Property Taxes	77
Introduction	78
A General Overview of Wisconsin’s Property Taxes	78
Property Tax Collections	79
Property Tax Structure	81
State Mechanisms Aimed at Reducing Property Tax Burdens	82
State-Provided Property Tax Credits and Programs	82
State Aid in the Form of “Shared Revenue”	83
Removing Items from Property Tax Funding	83
Levy Limitations	84
Consequences of Property Tax Relief Measures	84
Personal Property Taxes	85
Property Tax Administration	87
Property Tax Solutions	88
Continue Toward Repeal of Personal Property Tax	88
Allow Property Tax Limits to Continue Working	88
CHAPTER 7: Additional Important Considerations	89
Introduction	90
Transportation Funding in Wisconsin	90
Minimum Markup on Gasoline	93
Highway System in Wisconsin	93
Tolling Offers a New Revenue Source	94
Unemployment Insurance Taxes	94
Tax Triggers	96

A monochromatic teal photograph of a river flowing through a forest. The river is the central focus, winding through the landscape. The banks are lined with dense trees and foliage. The overall tone is dark and atmospheric. The word "INTRODUCTION" is overlaid in the upper-middle section in a bold, white, sans-serif font.

INTRODUCTION

Executive Summary

Wisconsin has struggled with its tax system for decades. The state has always been marked by high property tax burdens, but in its effort to “fix” them has leaned on corporate and individual income taxes to a sizable degree as well.

Wisconsinites are often flummoxed by why taxes are so high here—government services have a good reputation, but it isn’t always clear they are worth the price tag. Still other taxpayers feel they should be grateful as at least fiscal matters aren’t in as dire of straits as in Illinois. In recent legislative sessions, the legislature and administration have made strides to improve the roughest edges of the state’s tax system, but comprehensive tax reform has not been at the top of the agenda. We believe it ought to be.

Over the last year, our team of economists and tax experts at the Tax Foundation joined with Wisconsin’s own Badger Institute to investigate what can be done about the state’s tax system. Over the course of 12 months, our team met with over 100 stakeholders from all walks of Wisconsin life, including small business owners, local government officials, trade associations, industry representatives, state legislators, accountants and tax attorneys, and everyday taxpayers. We also reviewed the history of the fiscal system, previous tax reform studies, and historical revenue and economic trends.

The result is this book, which is meant to help Wisconsin achieve the goal of true tax reform—reform that benefits all taxpayers and sets the state on a competitive path in the region and in the nation. It’s meant to start the conversation about what Wisconsin does well, but also what it could do better—by recognizing strengths, diagnosing challenges, and prescribing real, workable solutions.

During our meetings across Wisconsin, several themes emerged:

- Individual income tax rates are high. At 7.65 percent, Wisconsin’s top individual income tax rate is among the highest nationally and regionally, and taxpayers are aware. This issue is especially acute in Milwaukee, where firms must compete for top professional talent with other states, and taxes can influence relocation decisions.
- Corporate tax rates are high but are significantly abated by the Manufacturing and Agriculture Credit (MAC). This credit shields manufacturing and agriculture firms from much of the burden of the state’s high tax rates, but many industries do not have access to it, and this unequal treatment discourages diversified investment in the Badger State.
- For many Wisconsin taxpayers, property tax burdens are a persistent political concern, but attempts at fixes have been costly. While property taxes are a local revenue stream, the state government has tried all sorts of levers to ameliorate the property tax burden, including reimbursing local governments for property tax credits, providing property tax credits on state income tax returns, and offering direct subsidies to local governments in the form of a “shared revenue” program.

- Wisconsin is a member of the Streamlined Sales Tax Project and adheres to the U.S. Supreme Court’s standards for online sales tax collection. The state began remote sales tax collection in 2018 and now has the opportunity to apply this new revenue stream toward comprehensive tax reform.

Our conversations with Wisconsinites from all walks of life were instrumental in our development of four comprehensive tax reform options tailored to the Badger State’s unique strengths and challenges. Informing every page of this book are the insights and perspectives we gained from those who interact with Wisconsin’s tax system on a daily basis.

With these valuable perspectives at the forefront of our minds, we undertook this project as an independent national organization familiar with tax developments in many states, with the view that tax systems should adhere to sound economic principles, including simplicity, transparency, neutrality, and stability. Positioning Wisconsin for the future means creating a tax code that can grow with the state, not hold it back. A tax code better aligned with growth, opportunity, and job creation is in the interest of all Wisconsinites.

While economic efficiency is only one lens through which to analyze a tax code, it is an important one. After all, there are many ways to generate a dollar of tax revenue, but some taxes are more harmful to the economy than others and should be mitigated wherever possible.

Major tax studies consistently find that taxes have a negative impact on economic growth, and that this impact varies across tax types and structures. Among major tax types, corporate income taxes tend to be the most harmful to economic growth, since they penalize capital investment, followed by individual income taxes, which impact individuals’ labor and savings decisions.³ Property and consumption taxes are less harmful because ultimately, it is production, innovation, and entrepreneurial risk-taking that drive economic growth.⁴ Within each of these taxes, moreover, the decisions states make—to carve out tax bases, incentivize or penalize certain economic decisions, or create or reduce complexity—have an effect as well. For example, Mullen and Williams (1994) found that higher marginal tax rates reduce gross state product growth.⁵

Each of the four comprehensive tax reform options presented in the pages ahead tackles Wisconsin’s tax dilemmas through a slightly different angle, but all four options present bold reforms and prioritize progress in key areas in which the state’s economic wellbeing is most at stake.

3 Jens Arnold, Bert Brys, Christopher Heady, Åsa Johannsson, Cyrille Schwellnus, and Laura Vartia, “Tax Policy for Economic Recovery and Growth,” *The Economic Journal* 121, no. 550 (February 2011).

4 See William McBride, “What is the Evidence on Taxes and Growth?” Tax Foundation, Dec. 18, 2012, <https://taxfoundation.org/what-evidence-taxes-and-growth>.

5 John K. Mullen and Martin Williams, “Marginal Tax Rates and State Economic Growth,” *Regional Science and Urban Economics* 24, no. 6 (December 1994).

We hope that this book and its recommendations will provide useful information and observations for policymakers, journalists, and citizens in the Badger State as they evaluate the state’s fiscal system. We are thankful to the Wisconsinites who spent time with us talking about Wisconsin’s taxes. Without their input, this publication would have been far less rich and meaningful. We are also grateful to the Wisconsin Department of Revenue for providing data to assist in estimating the fiscal impact of our proposed reforms.

Our Objective

We hope these solutions guide the tax reform conversation in Wisconsin by providing a framework upon which legislators and citizens can make further decisions. Each “option” in the menu of choices we present is designed to ensure the state builds a tax system for a diversified economy and positions itself as a destination for investment, entrepreneurs, and talented individuals in the years ahead.

Menu of Tax Reform Options

Our menu of comprehensive tax reform options is designed to allow legislators and taxpayers to reimagine their tax system to build an economy for the long term. Each of these plans streamlines the tax system, removes or consolidates duplicative provisions, and positions Wisconsin for long-term growth. They are designed with economic growth in mind, consistent with the literature on the economic effects of different tax types and structures.⁶ These plans are roughly revenue neutral, but if policymakers desire a net tax reduction or increase, rates can be dialed up or down accordingly.

Option A would transform Wisconsin's income tax into a streamlined, simplified flat tax, balanced by modernizing and increasing the sales tax. These changes would align the state's tax rates with competitor states, resembling changes enacted in the past decade in Indiana. It includes:

- A flat income tax rate of 4.82 percent
- A standard deduction that conforms with the new federal standard deduction created by the Tax Cuts and Jobs Act (TCJA), including elimination of Wisconsin's sliding scale so that the standard deduction becomes available to all taxpayers regardless of income
- A repeal of the personal exemption
- A moderately broadened sales tax base with a statewide rate of 5.75 percent, slightly higher than it is today
- A slightly lower corporate income tax of 7 percent
- Improvement in Wisconsin's ranking on our *State Business Tax Climate Index* from 32nd to 12th

Option B would recraft Wisconsin's tax system in a similar fashion to state-level tax reforms in other states, simplifying and reducing income and business taxes while broadening the sales tax to match today's economy. It includes:

- A consolidated income tax structure with rates of 4, 5, and 6.8 percent at thresholds of \$0, \$10,000, and \$40,000
- Conformity with the generous new federal standard deduction
- A repeal of the personal exemption
- Moderate sales tax base broadening at the current sales tax rate of 5 percent
- A reduction in the corporate income tax rate to 4.6 percent
- Improvement in Wisconsin's ranking on our *State Business Tax Climate Index* from 32nd to 14th

⁶ Karel Mertens and Morten Ravn, "The Dynamic Effects of Personal and Corporate Income Tax Changes in the United States," *American Economic Review* 103:4 (June 2013).

Option C would set Wisconsin apart as the only state in the region with no corporate income tax, making the state stand out as one of the few with no taxes on investment and job creation. Income tax rates are consolidated and reduced while the sales tax is broadened at the current rate. It includes:

- A full repeal of the corporate income tax, one of the biggest impediments to growth in the Badger State
- Large sales tax base broadening paired with a slightly higher sales tax rate of 5.2 percent
- A consolidated income tax structure with rates of 4, 5, and 6.8 percent at thresholds of \$0, \$10,000, and \$40,000
- Conformity with the generous new federal standard deduction
- A repeal of the personal exemption
- Substantial improvement in Wisconsin's ranking on our *State Business Tax Climate Index* from 32nd to 6th

Option D simplifies and stabilizes Wisconsin's existing tax system, broadening bases and adopting growth-friendly reforms while retaining progressivity, reducing business taxes, and keeping the current sales tax rate. It includes:

- A graduated individual income tax with rates of 4, 5, and 7.5 percent at thresholds of \$0, \$20,000, and \$150,000
- Elimination of the marriage penalty in the standard deduction but retention of the sliding scale as it exists under current law
- Retention of the current law personal exemption
- Moderate sales tax base broadening while maintaining the current 5 percent sales tax rate
- A reduction in the corporate income tax rate to 4 percent
- Improvement in Wisconsin's ranking on our *State Business Tax Climate Index* from 32nd to 14th

Improvements Included in All Options

In addition to the specific changes listed above, Options A, B, C, and D each include the following structural improvements to Wisconsin's tax code, designed to move to more neutral treatment of business and individual activities while improving the state's competitiveness in the region and nation:

Individual Income Tax

- Repeal the state's marriage penalty by doubling bracket widths for married couples and repealing the married couple credit
- Repeal the itemized deductions credit, as a more generous standard deduction available to all taxpayers (in Options A, B, and C) will reduce dependency on this credit

Corporate Income Tax

- Conform to the TCJA's new full expensing allowances under Internal Revenue Code (IRC) Sec. 168(k)
- Repeal the 3 percent surcharge levied on top of the corporate income tax and instead fund the Wisconsin Economic Development Corporation (WEDC) through the General Fund
- Conform with new federal standards for treatment of net operating losses (NOLs) under the TCJA
- Eliminate the throwback rule in the corporate income tax

Sales Tax

- Pursue sales tax base expansion (as detailed above and in Chapter 5)
- Share revenues from local flow-down of state base expansion between counties and municipalities
- Use revenue from the new online sales tax Supreme Court ruling to help pay for comprehensive reforms

Each of our reform solutions would improve Wisconsin's performance on our *State Business Tax Climate Index* overall and in the corporate tax, individual income tax, and sales tax components.

Wisconsin's Rankings on the *State Business Tax Climate Index*, Current (2019) and Proposed

	Overall Rank	Corporate Taxes	Individual Taxes	Sales Taxes
Current Law	32	35	39	8
Option A	12	10	15	9
Option B	14	4	30	7
Option C	6	1	30	7
Option D	14	3	33	7

Other Important Considerations

- Continue toward repeal of taxes on tangible personal property
- Allow property tax limits to continue working
- Consider tolling of Wisconsin's highways
- Repeal minimum markup law, which drives up gas prices
- Reform the state's unemployment insurance tax system

Key Elements of Wisconsin Tax Reform Options

	Current Wisconsin Tax System	Option A	Option B	Option C	Option D
Income Tax					
Income Tax Rate	Four Rates: 4% 5.84% 6.27% 7.65%	Single rate of 4.82%	Three rates: 4% 5% 6.80%	Three rates: 4% 5% 6.80%	Three rates: 4% 5% 7.50%
Tax-Free Income for Couples or Families (tax year 2018)	\$19,580 plus \$700 per exemption; phases down after \$22,000 in income	\$24,000	\$24,000	\$24,000	\$21,160 plus \$700 per exemption; phases down after \$22,000 in income
Tax-Free Income for a Single Filer with No Children (tax year 2018)	\$10,580; phases down after \$15,500 in income	\$12,000	\$12,000	\$12,000	\$10,580; phases down after \$15,500 in income
Itemized Deductions Credit	Yes	No	No	No	No
Marriage Penalty	Yes	No	No	No	No
Sales Tax (state portion)					
State Sales Tax Rate on Sales of Retail Goods to Consumers	5%, with many exemptions	5.75%; prescription drugs and medical devices exempt	5%; prescription drugs and medical devices exempt	5.2% on all items	5%; prescription drugs and medical devices exempt
State Sales Tax Rate on Sales of Retail Services to Consumers	Mostly Exempt	5.75%	5%	5.20%	5%
Corporate Income Tax					
Corporate Tax Rate	7.9% plus 3% surcharge	7%	4.60%	Repealed	4%
Connection to Federal Full Expensing and Net Operating Loss Rules	Does not conform	Conforms	Conforms	Conforms	Conforms
Throwback Rule Partly Taxing Out-of-State Income	Yes	No	No	No	No
Overall Estimates					
Revenue Estimate (2021)	\$16.5b	\$16.4b	\$16.4b	\$16.6b	\$16.4b
Distributional Effect	Slightly Progressive	More Regressive	Slightly Progressive	Slightly Progressive	Slightly Progressive
Rank on State Business Tax Climate Index	32nd	12th	14th	6th	14th

CHAPTER 1

**WISCONSIN'S
ECONOMY**



Introduction

Wisconsin's economy has grown consistently in recent years, paralleling the growth experienced by the U.S. overall. However, the state trails the U.S. in several key measures, including gross domestic product (GDP) per capita and personal income per capita. Compared to its neighbors, Wisconsin ranks near the middle of the pack in these same metrics.

Manufacturing, real estate, and government comprise the largest share of Wisconsin's economy. Manufacturing's share of the economy has declined over the past two decades, though it remains Wisconsin's largest industry and far outstrips the national average. Today, finance and insurance, professional and business services, and education and health services are some of Wisconsin's fastest-growing industries.

While many of Wisconsin's indicators are positive, there are also warning signs that policymakers would do well to heed. For example, Wisconsin took unusually long to recover from the Great Recession, only reaching its prerecession employment level halfway through 2015. Since 2005, moreover, the state has seen net outmigration as some Wisconsinites have found better opportunities outside the state. The population is also aging more rapidly than it is in neighboring states, births and K-12 enrollment have been on the decline, and college-educated individuals are leaving Wisconsin.

To provide context for future chapters, the following pages present an overview of the Badger State's economy, detailing the state's economic history and discussing what's ahead for the state's economy.

State Gross Domestic Product (GDP)

Wisconsin had the 20th largest economy in the United States in 2017, based on total gross domestic product (GDP).⁷ The state's overall economic output is less than it is in all neighboring states except Iowa (29th), though it ranks closely behind Indiana (16th) and Minnesota (17th).

After adjusting for population, Wisconsin's ranking drops slightly. In 2017, Wisconsin's GDP per capita ranked 25th nationally, trailing Illinois (12th), Minnesota (14th), and Iowa (17th) (Figure 1a).⁸

7 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Gross Domestic Product (GDP) by State (millions of current dollars)."

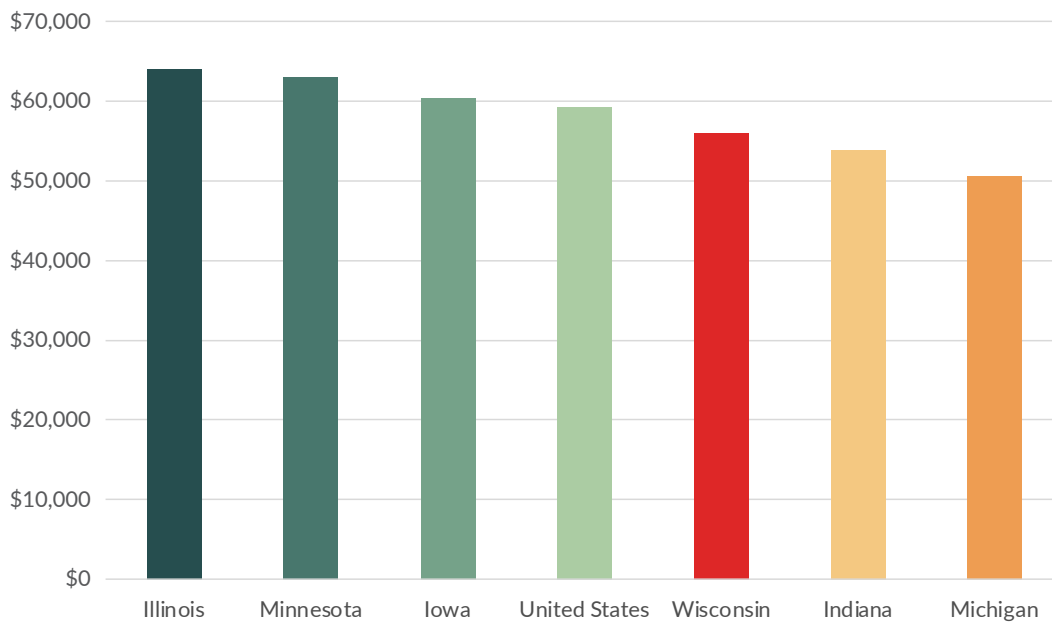
8 Ibid.

Figure 1b shows real GDP per capita for Wisconsin, its neighboring states, and the nation between 1997 and 2017.⁹ Wisconsin's real GDP per capita has consistently trailed Illinois and Minnesota over the last two decades. While Wisconsin has remained ahead of Michigan since 2003, the state's GDP per capita fell behind Iowa in 2004, and the gap between the two states has widened in recent years.

Compared to the national GDP per capita, Wisconsin's growth rate lagged the average in the mid-2000s but has generally paralleled the U.S. since 2009.¹⁰ However, a roughly \$3,000 gap persists between Wisconsin's GDP per capita and the national GDP per capita.

Figure 1c illustrates the annual percentage changes in real GDP over time for both Wisconsin and the U.S.

FIGURE 1a.
**State Gross Domestic Product Per Capita,
Wisconsin and Neighboring States, 2017**

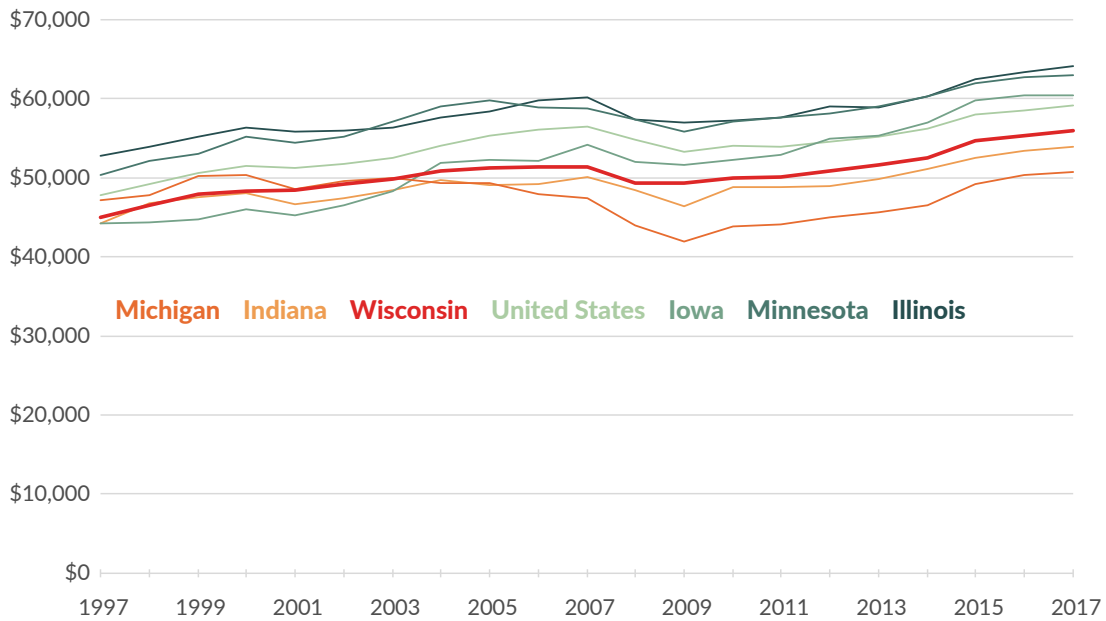


Source: Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*.

⁹ Ibid. U.S. Census Bureau, Population Division, "Annual Estimates of the Resident Population for the United States, Regions, States, and Puerto Rico" (Series Id: NST-EST2017-01).

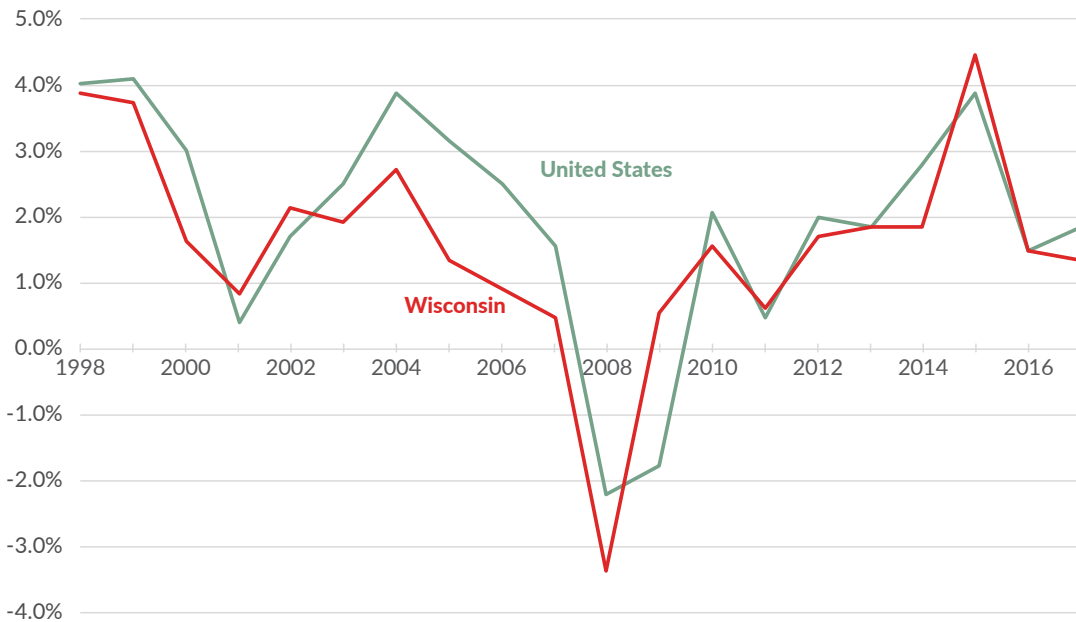
¹⁰ Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*, "Gross Domestic Product (GDP) by State (millions of current dollars)."

FIGURE 1b.
State Gross Domestic Product Per Capita, 1997-2017,
Wisconsin, Neighboring States (in 2017 dollars)



Note: Dollar amounts were adjusted for inflation and expressed in 2017 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
 Source: Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

FIGURE 1c.
Annual Percent Change in Real GDP, Wisconsin and the U.S.,
1998-2017



Note: Dollar amounts were adjusted for inflation and expressed in 2017 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.
 Source: Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

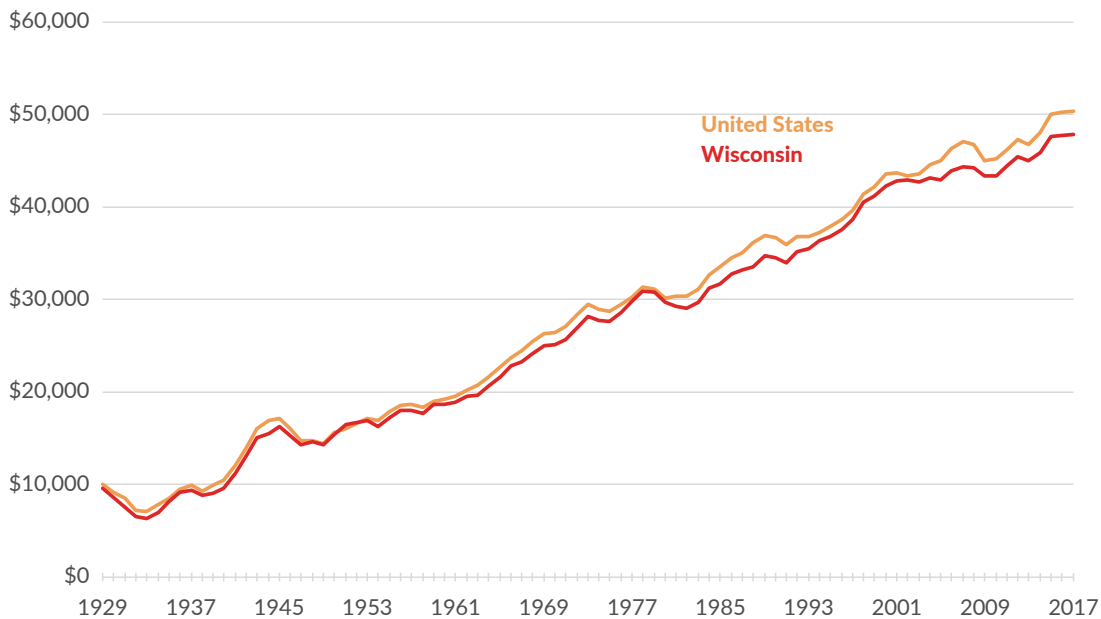
Personal Income

In 1929, the average inflation-adjusted personal income of a Wisconsin resident was \$9,590, 4 percent below the U.S. average of \$10,005.¹¹ Since then, Wisconsin has closely matched federal growth rates, although recently the state has begun to lose ground. As of 2017, Wisconsin's personal income per capita was \$47,850, trailing the national average by \$2,542, or 5 percent. Figure 1d shows inflation-adjusted personal income levels of Wisconsin and the U.S. from 1929 to present, and Figure 1e shows Wisconsin's and neighboring states' personal income per capita as a percentage of United States income.

While personal income per capita across the entire region has remained within about 15 percent of the U.S. in recent years, that has not always been the case. Compared to its peers, Wisconsin's personal income per capita as a percentage of the U.S. has remained quite stable over time, while neighboring states have experienced large swings (Figure 1e).

FIGURE 1d.

Personal Income Per Capita of Wisconsin and the U.S., 1929-2017 (in 2017 dollars)

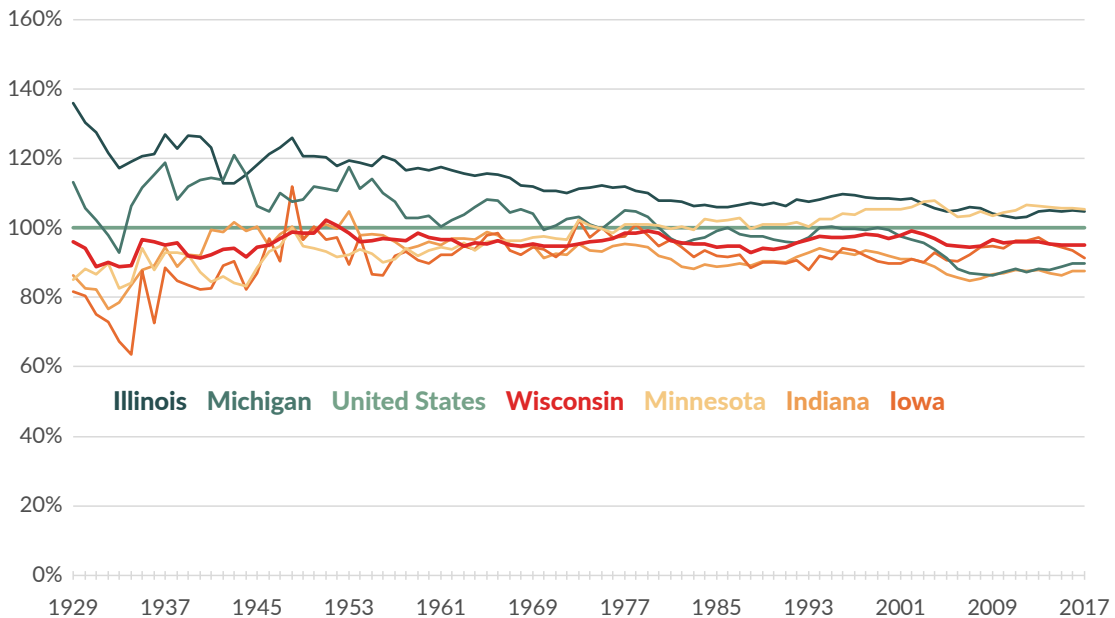


Note: Dollar amounts were adjusted for inflation and expressed in 2017 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.

Source: Bureau of Economic Analysis, Regional Economic Accounts, *Personal Income Summary: Personal Income, Population, Per Capita Personal Income (Table SA1)*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

11 Bureau of Economic Analysis, Regional Economic Accounts, *Personal Income Summary: Personal Income, Population, Per Capita Personal Income (Table SA1)*.

FIGURE 1e.
Personal Income Per Capita of Wisconsin and Neighboring States as a Percentage of U.S. Income, 1929-2017



Source: Bureau of Economic Analysis, Regional Economic Accounts, *Personal Income Summary: Personal Income, Population, Per Capita Personal Income* (Table SA1).

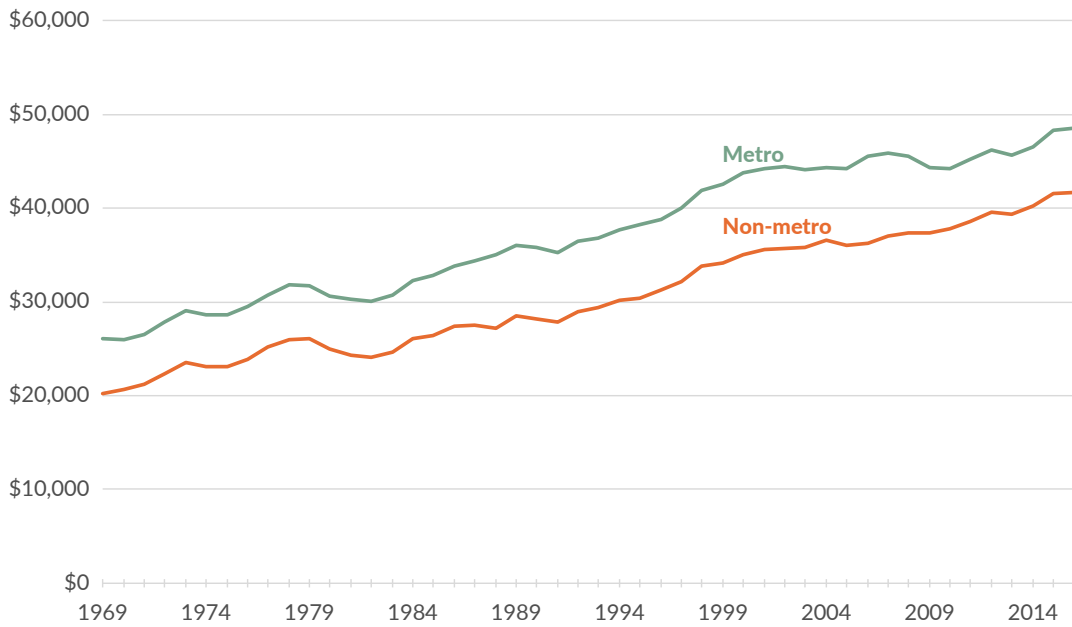
Unsurprisingly, metropolitan areas perform better economically than nonmetropolitan areas. In 2006, the gap between metro and non-metro areas within Wisconsin peaked at \$9,232, and in 2014 the gap declined to its smallest measure on record, \$6,312 (Figure 1f).¹²

Many of these economic measures vary across Wisconsin’s regions, or Metropolitan Statistical Areas (MSAs).¹³ For example, in the Madison and Milwaukee MSAs, GDP per capita is higher than the national average (Figure 1g). On the other hand, the Racine MSA has the lowest GDP per capita of areas we examined, measuring nearly \$30,000 below the Madison region.¹⁴

The comparative differences among Wisconsin’s metropolitan areas have evolved over time (Figure 1h). All of Wisconsin’s MSAs saw GDP per capita decline following the recession, but their degree of recovery since then has been varied.¹⁵ For example, in the years following the recession, the Madison MSA has seen steady growth, while the Racine MSA has declined.

12 Bureau of Economic Analysis, Regional Economic Accounts, Local area Personal Income and Employment, *Personal Income Summary: Personal Income, Population, and Personal Income Per capita* (Table CA1); Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).
 13 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by Metropolitan Area*.
 14 Ibid.
 15 Ibid.

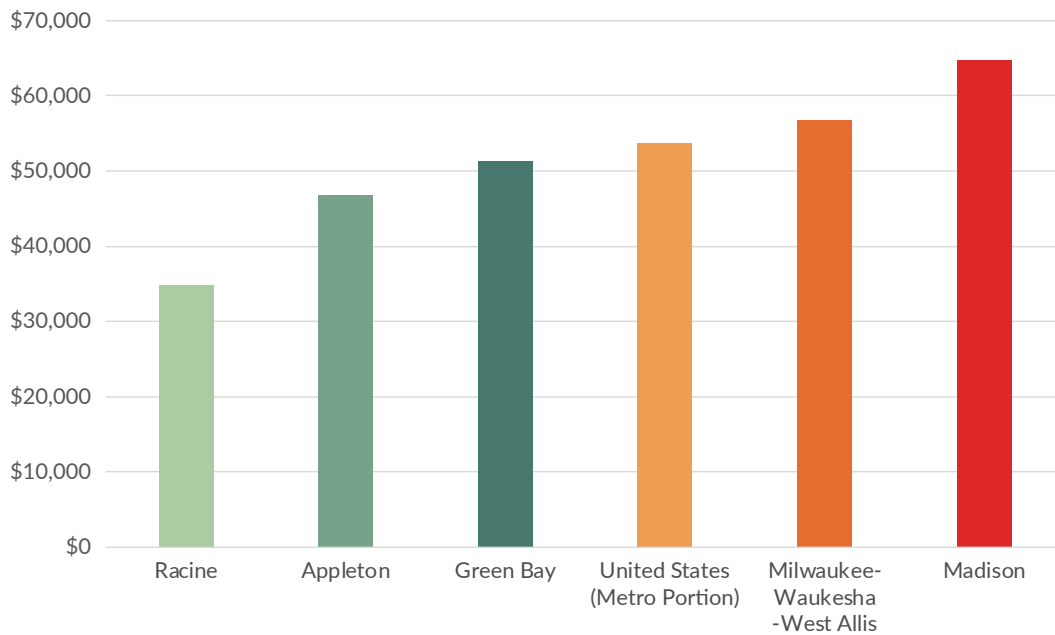
FIGURE 1f.
Personal Income Per Capita, Wisconsin, 1969-2016 (in 2016 dollars)



Note: Dollar amounts were adjusted for inflation and expressed in 2016 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.

Source: Bureau of Economic Analysis, Regional Economic Accounts, Local area Personal Income and Employment, *Personal Income Summary: Personal Income, Population, and Personal Income Per capita (Table CA1)*; Bureau of Labor Statistics, *Consumer Price Indexes (All*

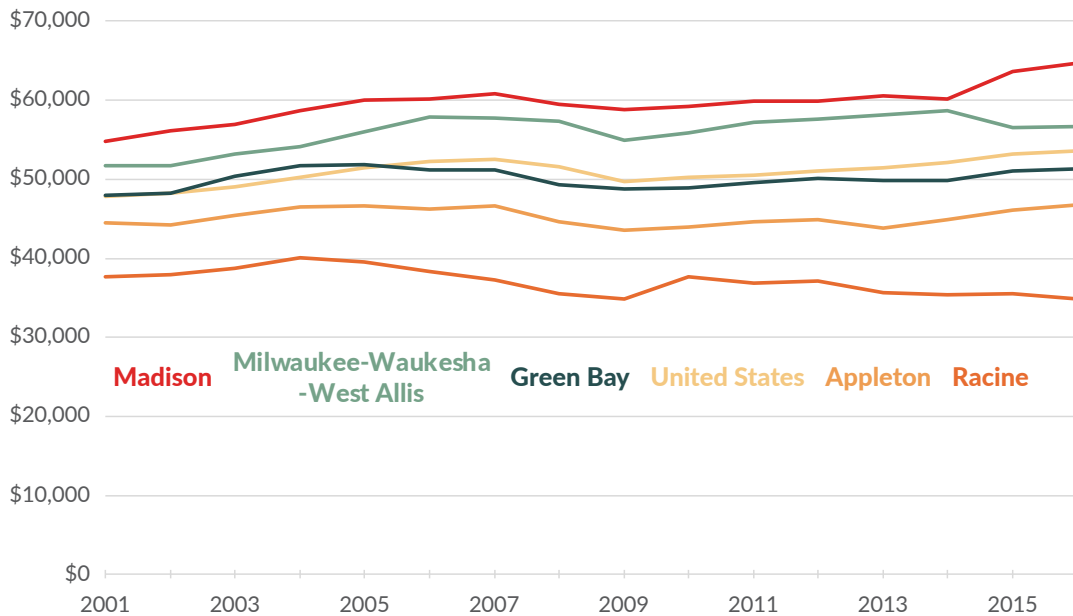
FIGURE 1g.
Wisconsin Gross Domestic Product by Metropolitan Statistical Area, 2016 (chained 2009 dollars)



Source: Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by Metropolitan Area*.

FIGURE 1h.

Wisconsin Gross Domestic Product by Metropolitan Statistical Area, 2001-2016 (chained 2009 dollars)



Source: Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by Metropolitan Area*.

Major Industries

In 2017, Wisconsin’s five largest industries were manufacturing (18.6 percent), real estate and rental leasing (12.1 percent), government and government enterprises¹⁶ (10.9 percent), professional and business services (9.6 percent), and healthcare and social assistance (8.7 percent).¹⁷

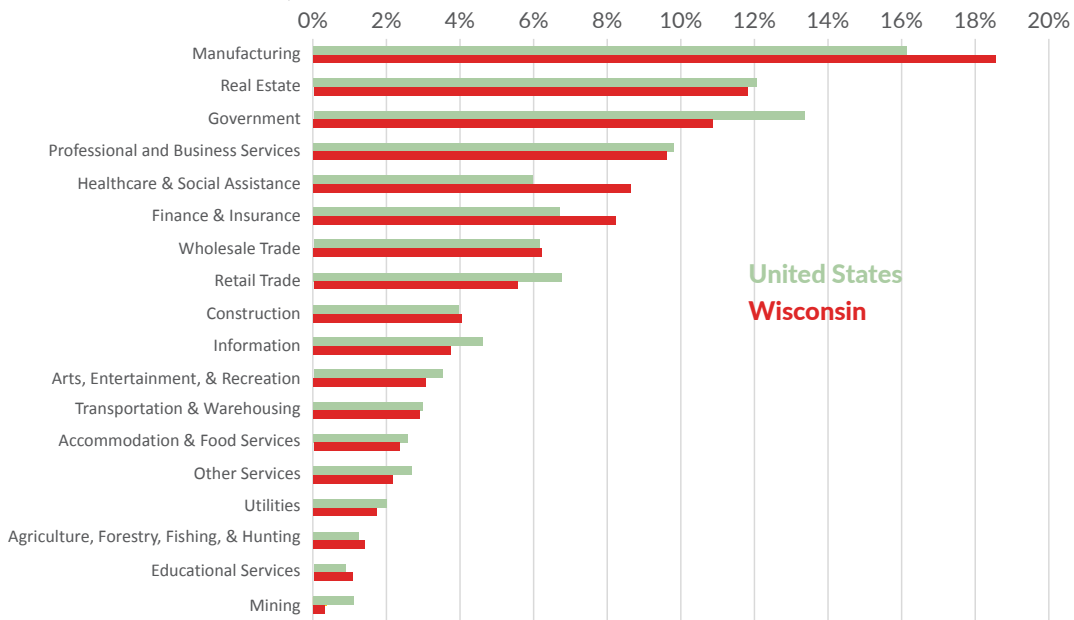
Wisconsin’s industry mix differs from that of the U.S. at large. Most notably, the manufacturing sector comprises a larger share of Wisconsin’s economy (18.6 percent) than it does the nation as a whole (16.1 percent). The state also has a noticeably larger share of the healthcare and social assistance as well as the finance and insurance industries. On the other hand, government and government enterprises and retail trade make up a smaller share of Wisconsin’s economy than of the U.S. economy.

Over the past two decades, several notable trends have occurred. From 1997 to 2017, the size of the manufacturing industry has decreased from just over 25 percent of the state’s total GDP to 18.6 percent. Though still by far the largest sector in the state, its share of the economy has declined over the past decade while other sectors have grown. Finance and insurance and the professional and business sectors have experienced the most growth over those two decades.

16 The Bureau of Economic Analysis defines “government enterprises” as “government agencies that cover a substantial portion of their operating costs by selling goods and services to the public and that maintain their own separate accounts.”

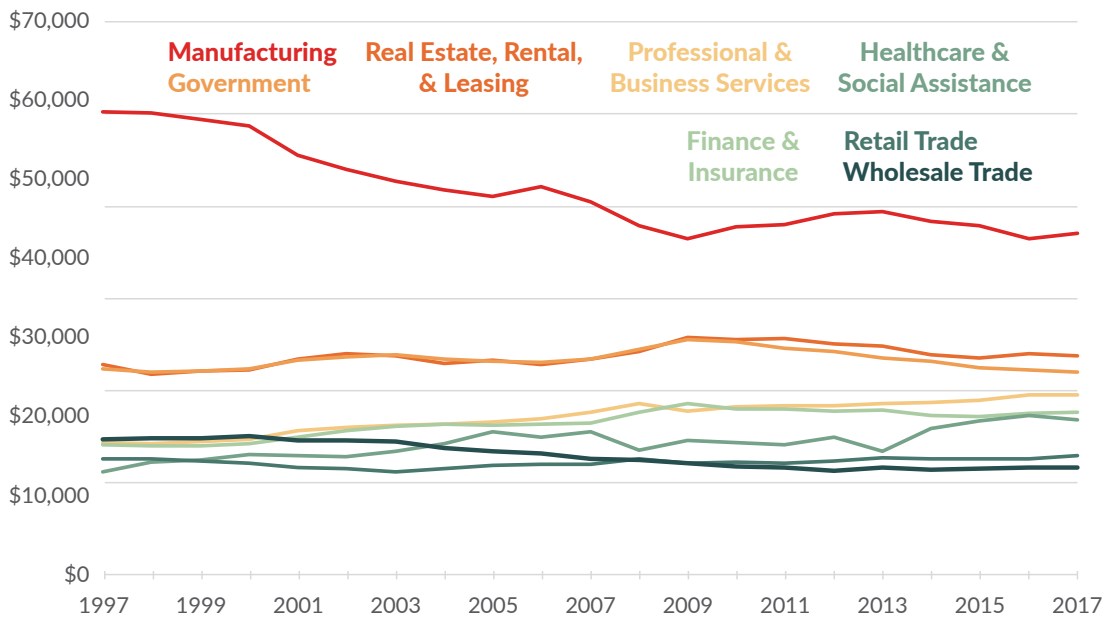
17 Bureau of Economic Analysis, Regional Economic Accounts, *Gross Domestic Product (GDP) by State*.

FIGURE 1i.
Percentage of Total State Gross Domestic Product by Industry, Wisconsin and U.S., 2017



Source: Bureau of Economic Analysis, Regional Economic Accounts, Gross Domestic Product (GDP) by State.

FIGURE 1j.
Percent of Total State Gross Domestic Product by Industry, 1997-2017



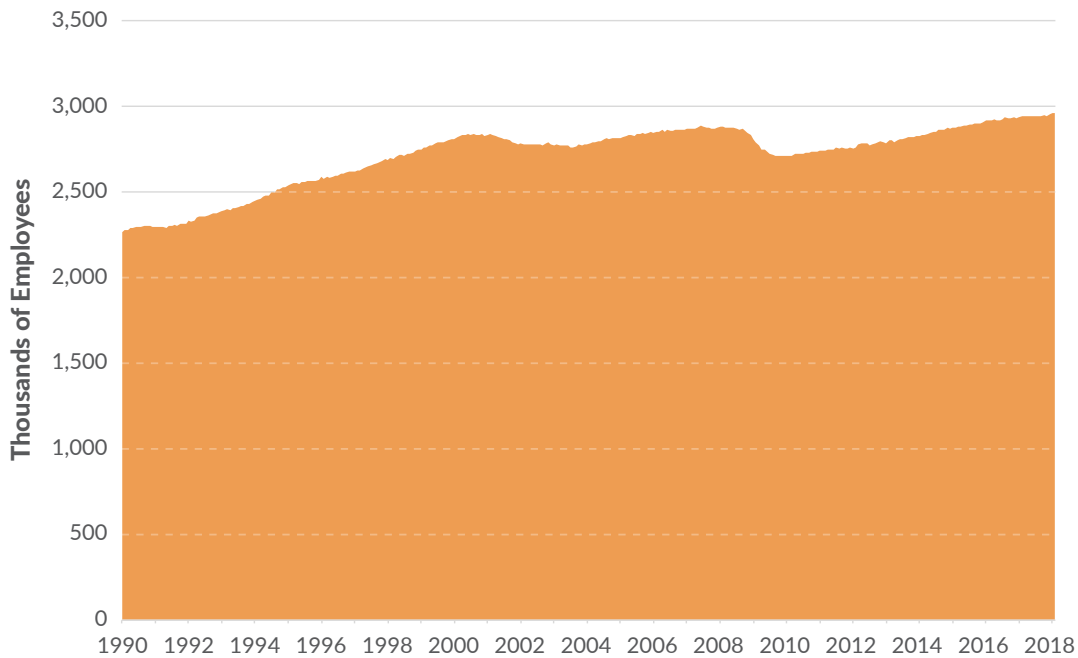
Source: Bureau of Economic Analysis, Regional Economic Accounts, Gross Domestic Product (GDP) by State.

Employment

Employment in Wisconsin has risen 30.7 percent since 1990 but only 5.4 percent since 2000.¹⁸ Wisconsin lost an estimated 177,000 jobs during the Great Recession, sustaining a peak unemployment rate of 9.2 percent, which was slightly lower than the national unemployment peak of 10 percent.¹⁹ In August 2018, Wisconsin's unemployment rate of 3.0 percent was among the lowest in the nation.²⁰

FIGURE 1k.

Total Nonfarm Employment, 1990-2018



Source: U.S. Bureau of Labor Statistics, *All Employees: Total Nonfarm in Wisconsin*.

The manufacturing sector is the largest employer in Wisconsin, comprising 16 percent of total state nonfarm employment in 2017.²¹ The next largest sectors in terms of employment are education and health services at 15.3 percent, government (13.8 percent), professional and business services (11 percent), and retail trade (10.3 percent). Figure 1l shows the breakdown of nonfarm employment categories within the state, organized by broad sector categories provided by the Bureau of Labor Statistics.

Like the decrease in manufacturing as a share of total state GDP, manufacturing's share of employment has also been in steady decline (see Figure 1m). Employment in the education and health services sector, as well as in the professional and business services industry, has risen in recent years, while employment in other top industries has remained relatively flat.

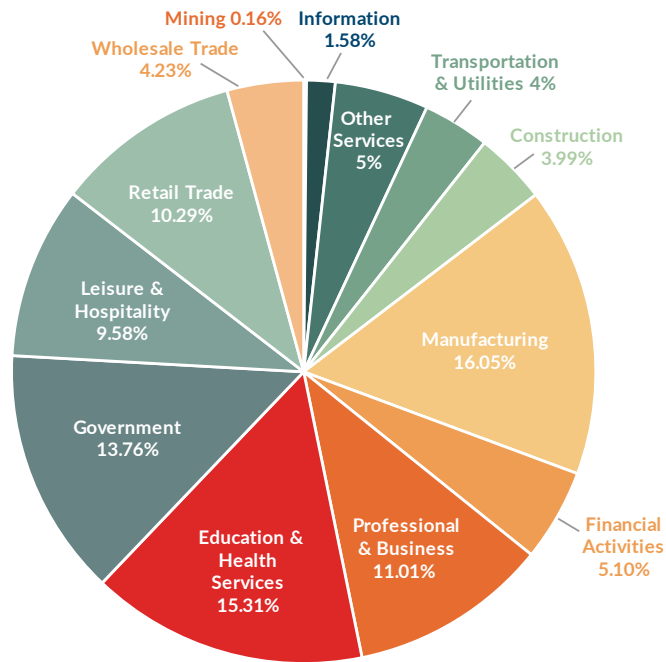
18 U.S. Bureau of Labor Statistics (BLS), "All Employees: Total Nonfarm in Wisconsin, Thousands of Persons, Monthly, Seasonally Adjusted."

19 BLS, "Labor Force Statistics for Current Population, Unemployment Rate, (Series Id. LNS14000000)."

20 BLS, "Civilian labor force and unemployment by state and selected area, seasonally adjusted."

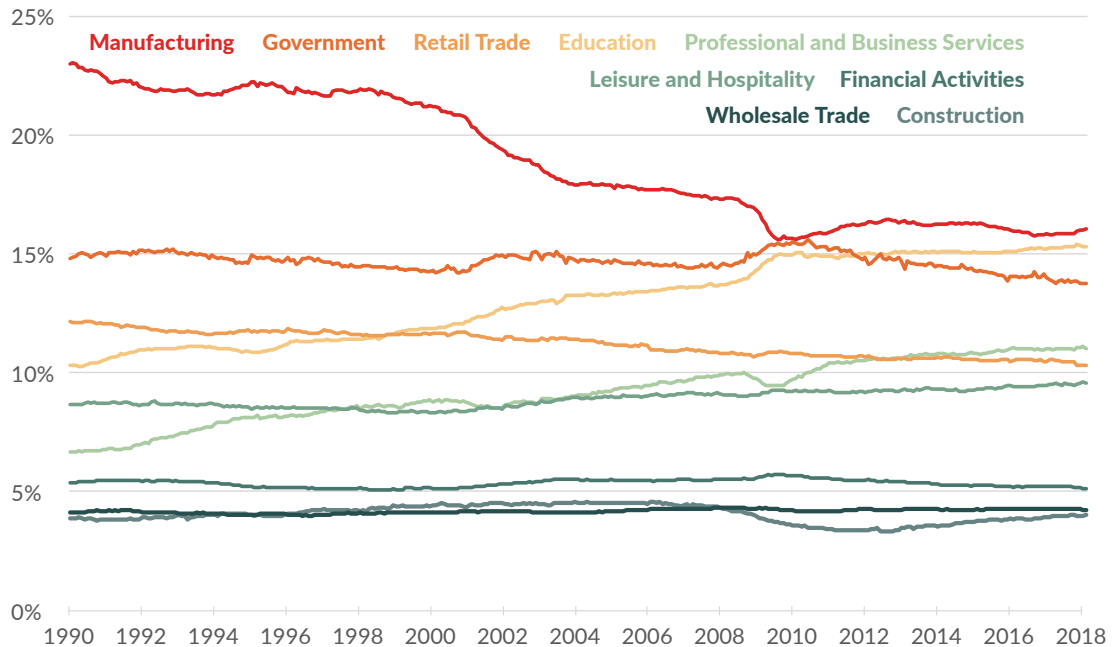
21 Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*.

FIGURE 1L.
Percent of Total Nonfarm Employment by Industry, 2018



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*.

FIGURE 1m.
Nonfarm Employment by Industry, 1990-2018



Source: Bureau of Labor Statistics, *State and Area Employment, Hours, and Earnings*.

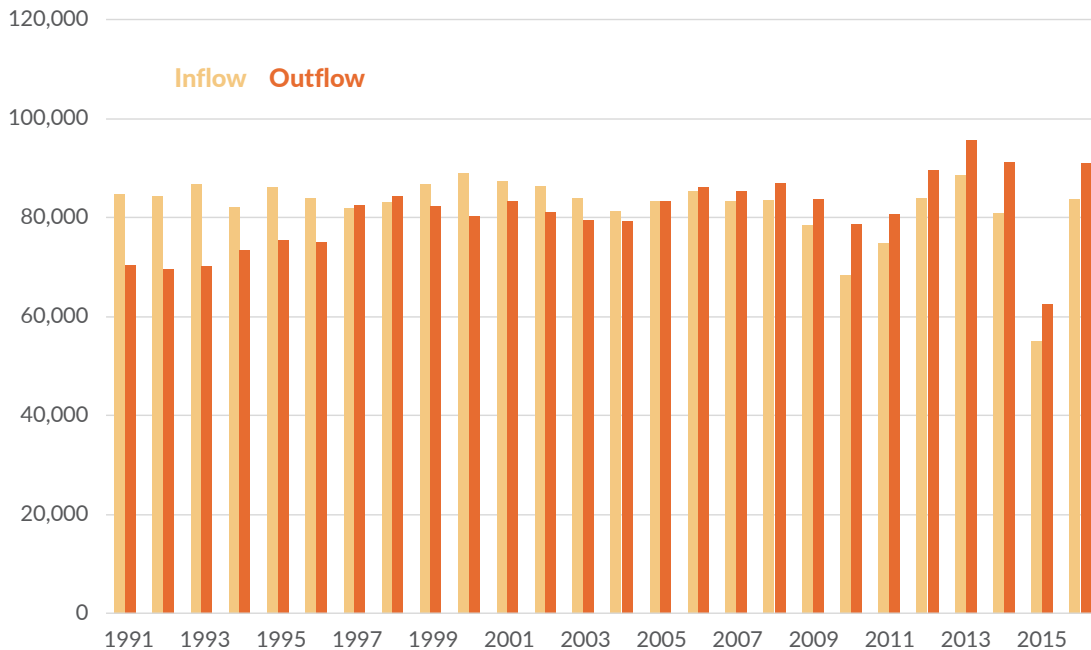
Migration Patterns

One way to measure migration among states is to look at the movement of individual federal income tax filers between states and abroad over time. The Internal Revenue Service's State Migration Data shows the inbound and outbound number of federal tax exemptions, which serves as our measure of "people."

From 1991 until 2004, migration into Wisconsin exceeded outbound migration all years except 1997 and 1998, for a total gain of 100,827 people.²² However, outflows have exceeded inflows every year since 2005, resulting in a loss of 65,596 people.²³ From 2010 to 2016 alone, Wisconsin experienced a net outflow of 53,927 people. Figure 1n illustrates these migration trends over time.

In addition to the recent net outflow of people from Wisconsin, there is a rising concern of an aging population. Compared to nearby states, Wisconsin has the second lowest percentage of residents under age 19 and the lowest percentage of residents under age 29. Wisconsin is also among the states with the highest percentages of residents age 60 and older (Figure 1o).²⁴

FIGURE 1n.
Migration In and Out of Wisconsin, 1991-2016



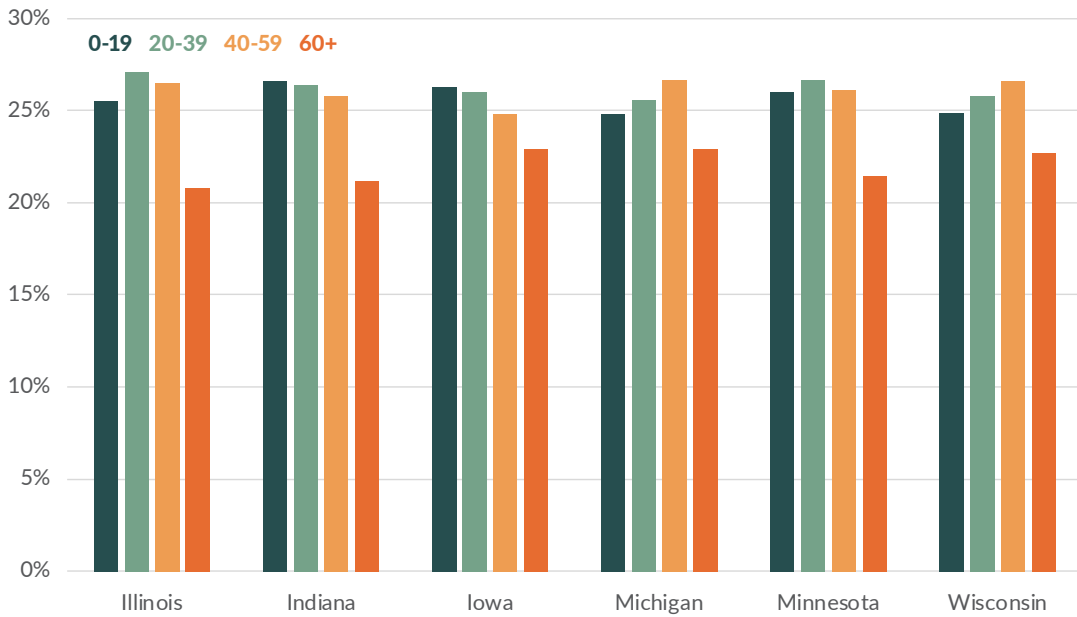
Source: Internal Revenue Department: *Statistics of Income Tax Stats – Migration Data*, "U.S. Population Migration Data."

²² Internal Revenue Department: *Statistics of Income Tax Stats – Migration Data*, "U.S. Population Migration Data." It should be noted that there are discrepancies between the migration data from the Internal Revenue Service and from the U.S. Census Bureau.

²³ Ibid.

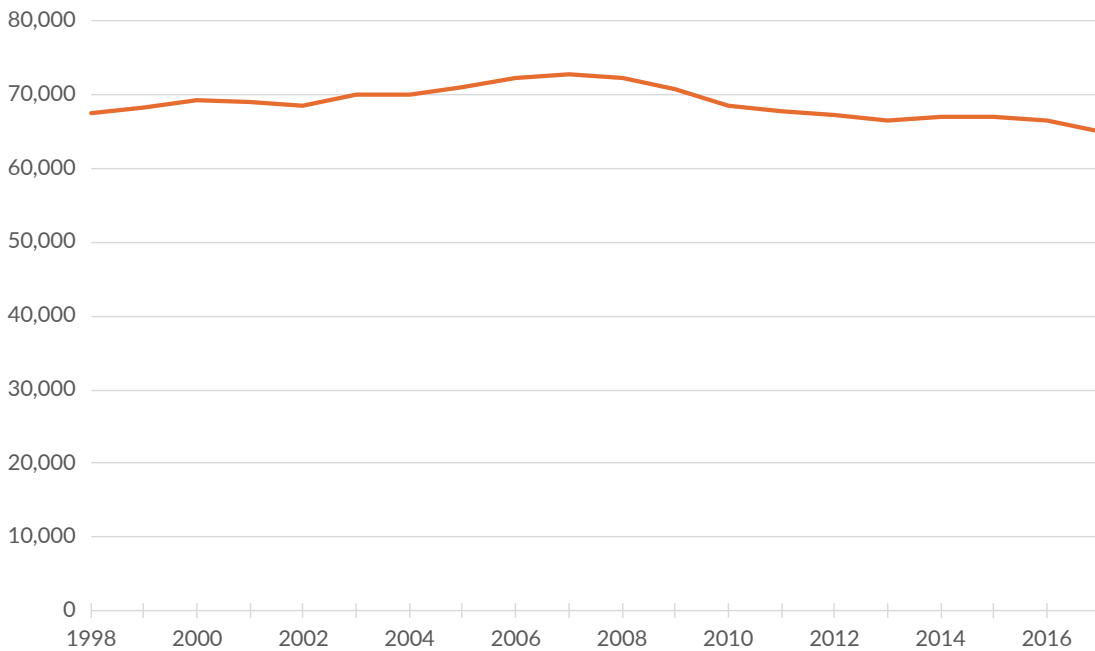
²⁴ U.S. Census Bureau, Population Division, "Annual Estimates of the Resident Population by Sex, Age, Race, and Hispanic Origin for the United States and States," <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>.

FIGURE 1o.
Age Groups as a Percentage of Total Population, Wisconsin and Neighboring States, 2016



Source: U.S. Census Bureau, Population Division, "Annual Estimates of the Resident Population by Sex, Age, Race, and Hispanic Origin for the United States and States."

FIGURE 1p.
Number of Live Births in Wisconsin, 1998-2017



Source: Centers for Disease Control and Prevention, "National Vital Statistics Reports," Final Data for 1998-2017, https://www.cdc.gov/nchs/data/nvsr/nvsr48/nvs48_03.pdf.

In addition to an aging population, Wisconsin is experiencing other demographic challenges. As pictured in Figure 1p, births in Wisconsin have been declining in recent years, falling to 64,975 in 2017 from a peak of 72,784 in 2007. Likewise, K-12 enrollment in the Badger State has fallen from 874,098 in the 2005-2006 school year to 860,138 in the 2017-2018 school year, a decline of 1.6 percent.²⁵ A third issue is that of “brain drain”: One estimate shows that between 2008 and 2012, Wisconsin lost an average of 14,000 college graduates per year, primarily between the ages of 21 and 29.²⁶

25 Wisconsin Information System for Education Data Dashboard, <https://wisedash.dpi.wi.gov/Dashboard/portalHome.jsp>.

26 Shamane Mills, “Brain Drain’ Continues As More Young Graduates Leave Wisconsin,” Wisconsin Public Radio, July 22, 2014.

An aerial photograph of the Wisconsin State Capitol building in Madison, Wisconsin, featuring a prominent central dome and classical architectural details. The building is surrounded by urban structures and greenery, with a large body of water visible in the background. The entire image is overlaid with a semi-transparent green filter.

CHAPTER 2

**WISCONSIN'S
TAX AND BUDGET
STRUCTURE**

Introduction

Spending in Wisconsin has increased significantly in recent years. Total state spending increased by 47 percent from 1995 to 2017, significantly faster than population growth over the same period. Notably, most spending growth occurred in the period preceding the Great Recession and has slowed in years since.

While other chapters will examine each major tax type in Wisconsin, this chapter provides a brief overview of the tax system and budget structure as a whole. It also examines the state's performance on our *State Business Tax Climate Index*, a measure of tax structure, both overall and on the *Index's* constituent components (corporate, individual, sales, property, and unemployment insurance taxes).

The issue of tax competitiveness has to do with *how* tax revenue is generated; it is for lawmakers to determine *how much* is collected. In Wisconsin, individual income taxes and sales taxes generate approximately 72 percent of state tax collections. Many elements of the state's tax system, however, stand in the way of competitiveness. For example, the structure of the state's individual income tax ranks poorly compared to other states, and the state corporate income tax is levied at a relatively high rate.

Following the overview of Wisconsin's tax and budget structure, this reform book will explore the current tax code in the Badger State, highlighting uncompetitive policies and offering recommendations for improvement.

Recent Tax and Spending Policies

Wisconsin's inflation-adjusted expenditures increased from \$19.33 billion in 1995 to \$28.42 billion in 2017 (Figure 2a).²⁷ This was a 47 percent surge in inflation-adjusted expenditures, compared to 17 percent population growth and 39 percent inflation-adjusted revenue growth over the same period.²⁸ That said, much of the increase in spending occurred between 1995 and 2008; since that time, spending has slowed.

Wisconsin's largest expenditure is human relations and resources, chiefly comprised of Medicaid, Temporary Assistance for Needy Families (TANF), and state correctional costs. Spending in this category grew substantially following the Great Recession due to the federal American Recovery and Reinvestment Act (stimulus).²⁹ Education spending is the next largest category in Wisconsin, reaching a peak value of 31 percent of total state spending in 1998 but settling closer to 25 percent in recent years. The Badger State also remains one of the only states with a nearly fully-funded pension system for public sector employees.³⁰ See Figure 2b for a complete illustration of Wisconsin's expenditures from 1991 to 2017.

27 State of Wisconsin, Department of Administration, Comprehensive Annual Financial Reports: 2017, 2008, 2000.

28 U.S. Census Bureau, State Intercensal Datasets; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

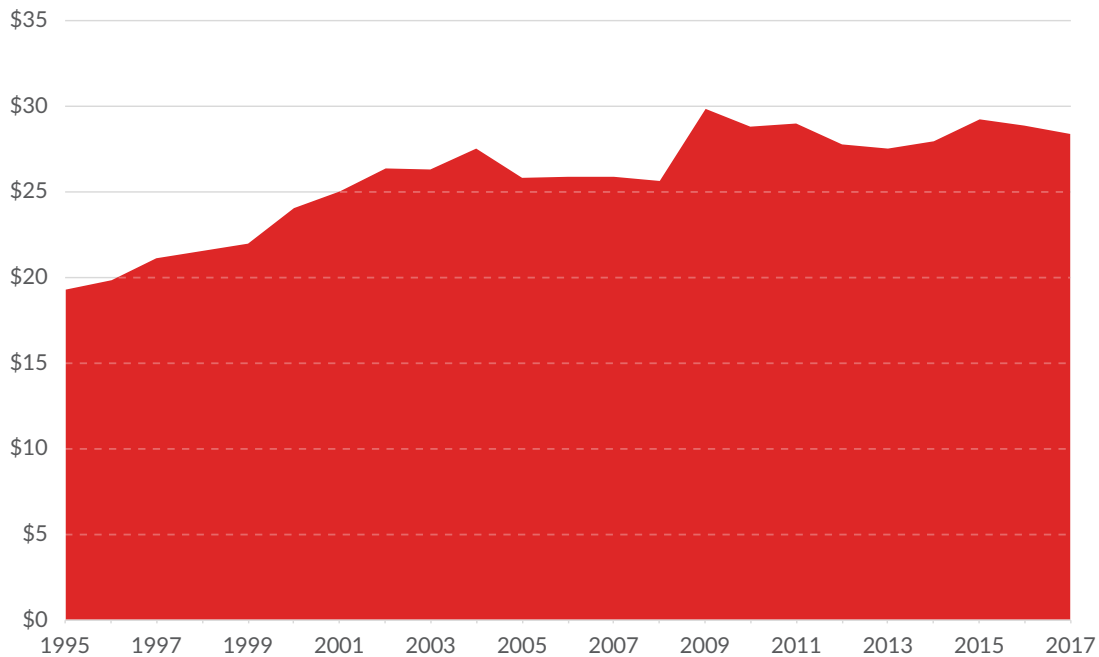
29 State of Wisconsin, Department of Administration, Comprehensive Annual Financial Reports: 2017, 2008, 2000.

30 State of Wisconsin, Department of Employee Trust Funds, "WRS Active Lives Valuation & Gain/Loss Analysis," June 1, 2018.

Between 1995 and 2017, total state tax collections grew by 24.9 percent after adjusting for inflation.³¹ Similar to the growth in Wisconsin's expenditures, most of the state's tax collections growth occurred during the 1990s, increasing by 23.3 percent from 1995 to 2000 on an inflation-adjusted basis. From 2000 to 2017, inflation-adjusted state tax collections grew by just 1.3 percent. See Figure 2c for an illustration of Wisconsin's tax collections over the past two decades.

FIGURE 2a.

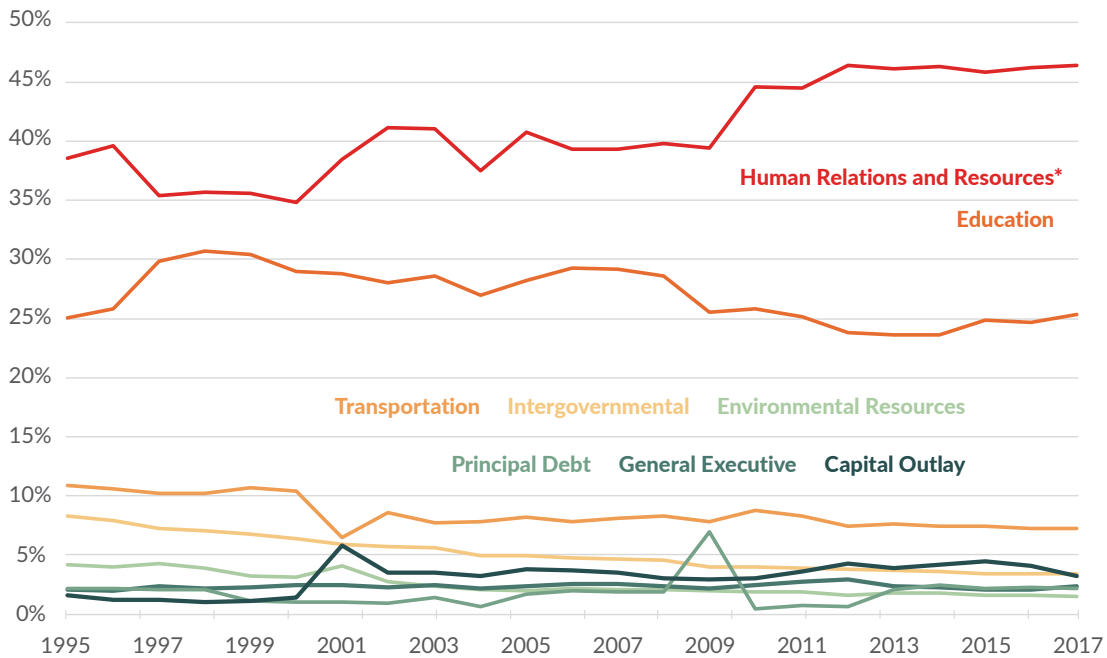
Wisconsin Total Expenditures, 1995-2017 (Billions of 2017 Dollars)



Source: State of Wisconsin, Department of Administration; Comprehensive Annual Financial Reports: 2017, 2008, 2000.

FIGURE 2b.

Wisconsin Expenditures by Source as a Percent of Total, 1995-2017

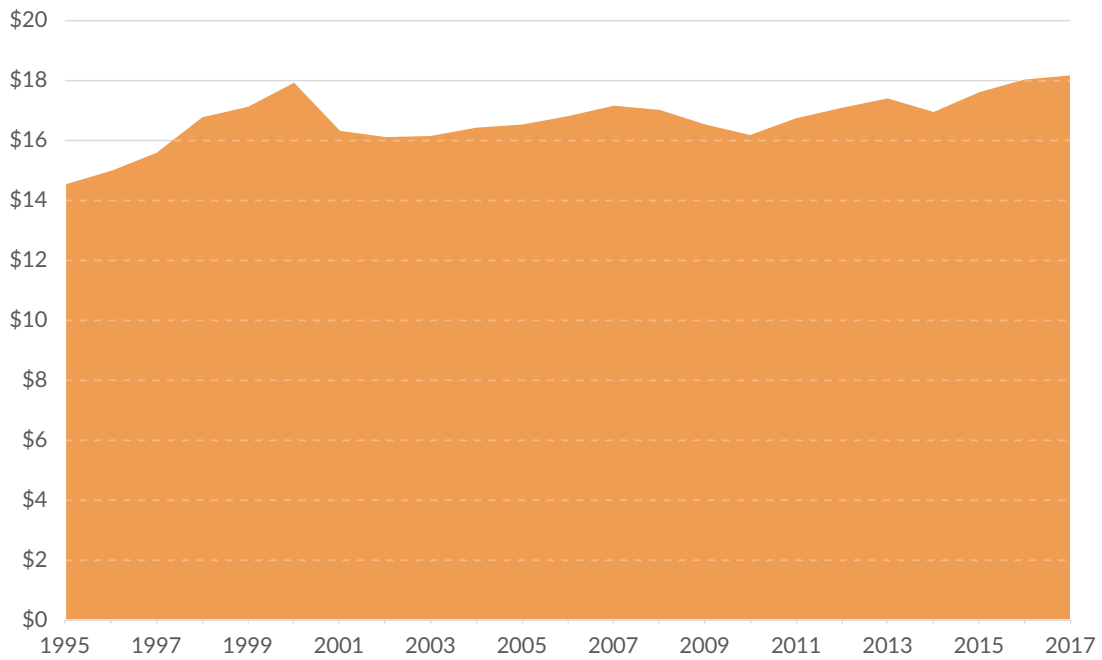


Note: The Human Relations and Resources category is composed mainly of Medicaid, Temporary Assistance for Needy Families (TANF), and state correctional costs.

Source: State of Wisconsin, Comprehensive Annual Financial Reports: 2017, 2008, 2000.

FIGURE 2c.

Wisconsin Total Tax Collections, 1995-2017 (Billions of 2017 Dollars)



Source: U.S. Census Bureau, 2016 Annual Survey of State Tax Collections.

Wisconsin's Budget Makeup

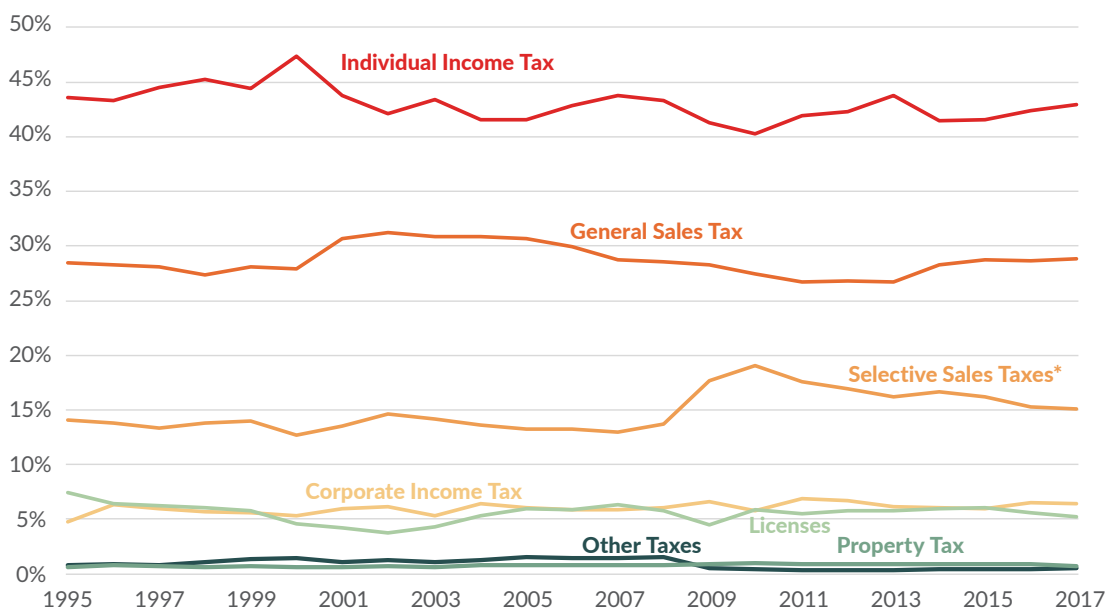
The individual income tax and sales tax are Wisconsin's largest sources of tax revenue, comprising 43 percent and 29 percent of total state tax collections, respectively.³² Selective sales taxes, chiefly made up of alcohol, tobacco, fuel, and utility taxes, also comprise a significant portion of the state's revenue. Property taxes, which are almost exclusively a local levy, are only a small component of state-level tax collections. Figure 2d shows the percentage of total state tax collections attributable to each of the major taxes between 1995 and 2017. Figure 2e highlights Wisconsin's state and local tax collections between 1995 and 2016, which shows a heavy reliance on property taxes for revenue at the local level.

While taxes are the largest source of revenue for the state, Wisconsin also relies on federal funding. Following the Great Recession, the state saw a significant uptick in federal funding from the American Reinvestment Recovery Act of 2009 (see Figure 2f).³³ As a result of the recession, both individual and corporate income tax revenue decreased between 2008 and 2010, which boosted the state's reliance on federal aid. Since 2010, however, federal funding as a percentage of Wisconsin's total revenue has steadily declined and is on a trajectory to reach prerecession levels.

Figure 2g compares year-over-year changes in revenue collections for three of Wisconsin's revenue streams—individual income, sales, and corporate income—since 1994.³⁴ The volatility of the corporate income tax is immediately apparent. While all taxes can be volatile, corporate income taxes are especially so.

FIGURE 2d.

Wisconsin State Tax Collections as a Percent of Total, 1995-2017



* Note: The Selective Sales Taxes category includes alcohol, tobacco, fuel, and utility taxes.
Source: U.S. Census Bureau, Annual Surveys of State Tax Collections.

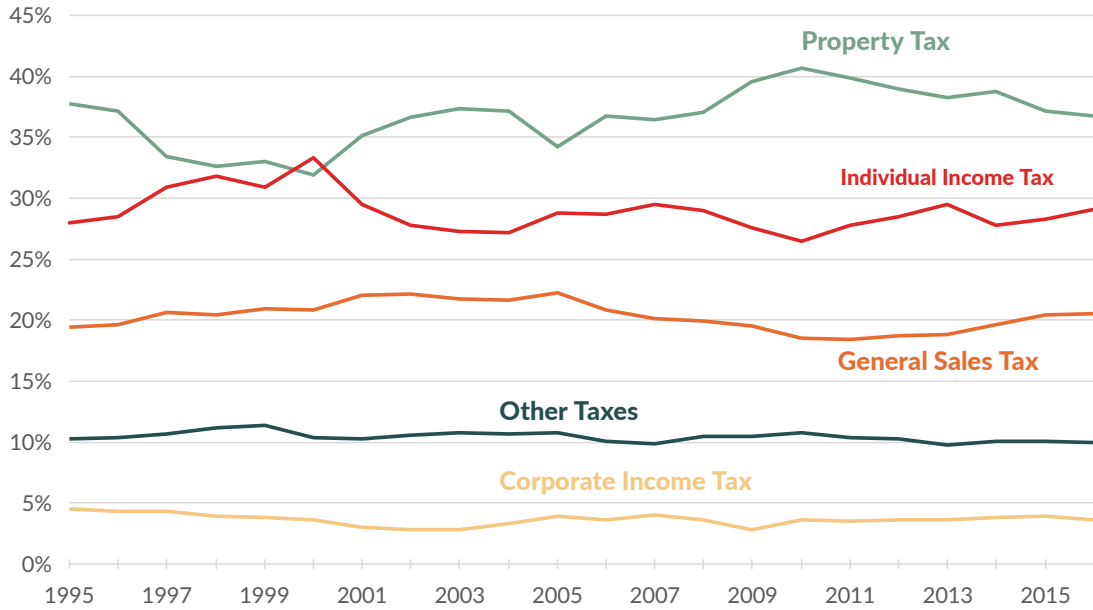
32 U.S. Census Bureau, "2016 State & Local Government Finance Historical Datasets and Tables," <https://www.census.gov/data/datasets/2016/econ/local/public-use-datasets.html>.

33 State of Wisconsin, Comprehensive Annual Financial Reports: 2017, 2008, 2000.

34 U.S. Census Bureau, Annual Surveys of State Tax Collections.

FIGURE 2e.

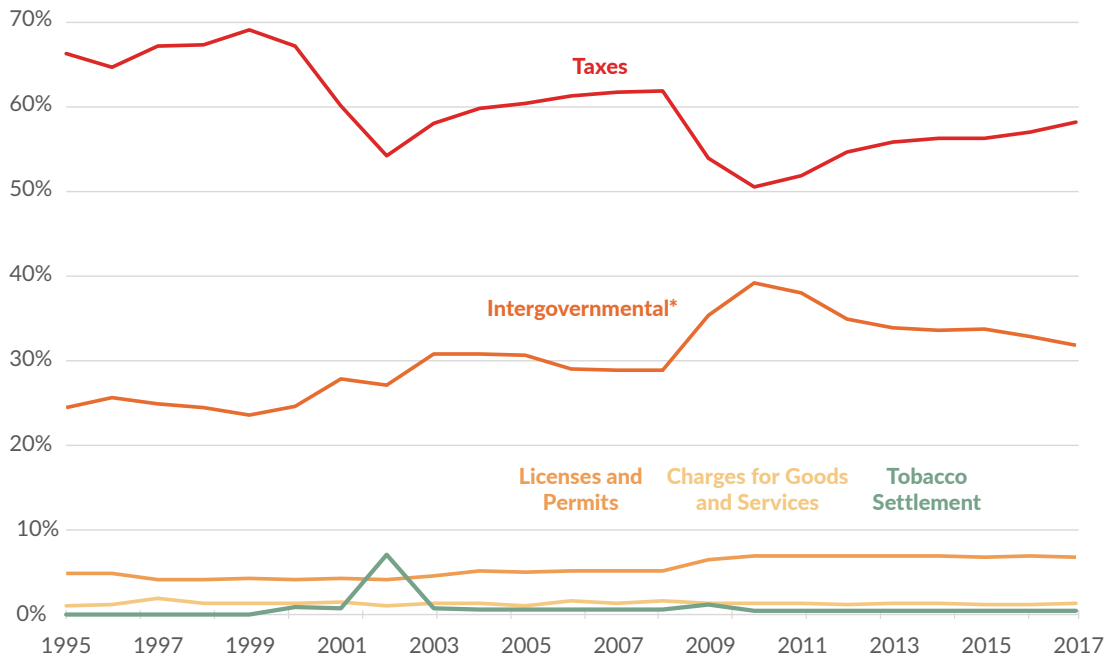
Sources of Wisconsin State & Local Tax Collections as Percent of Total, 1995-2016



Source: Wisconsin Department of Revenue, Wisconsin State & Local Taxes FY86-FY16.

FIGURE 2f.

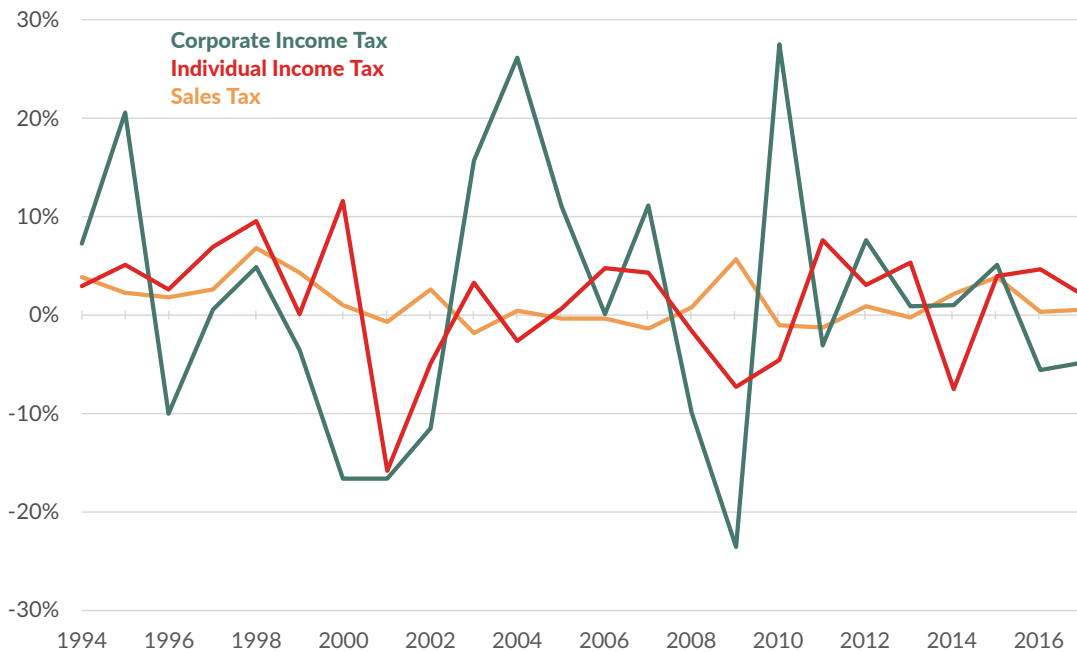
Sources of Wisconsin Revenue as Percent of Total, 1995-2017



Note: Per the U.S. Census Bureau, Intergovernmental expenditures include federal grants and aid, reimbursements for state activities, and revenue received but transmitted through the state to local governments. For more, see U.S. Census Bureau, "Government Finance and Employment Classification Manual".

Source: State of Wisconsin, Comprehensive Annual Financial Reports: 2017, 2008, 2000.

FIGURE 2g.

Wisconsin Tax Collection Volatility, 1994-2017

Dollar amounts were adjusted for inflation and expressed in 2017 dollars prior to calculating percentage changes using the Consumer Price Index for All Urban Consumers (CPI-U) from the Bureau of Labor Statistics.

Source: U.S. Census Bureau, State & Local Government Finance.

Measures of State Tax Competitiveness

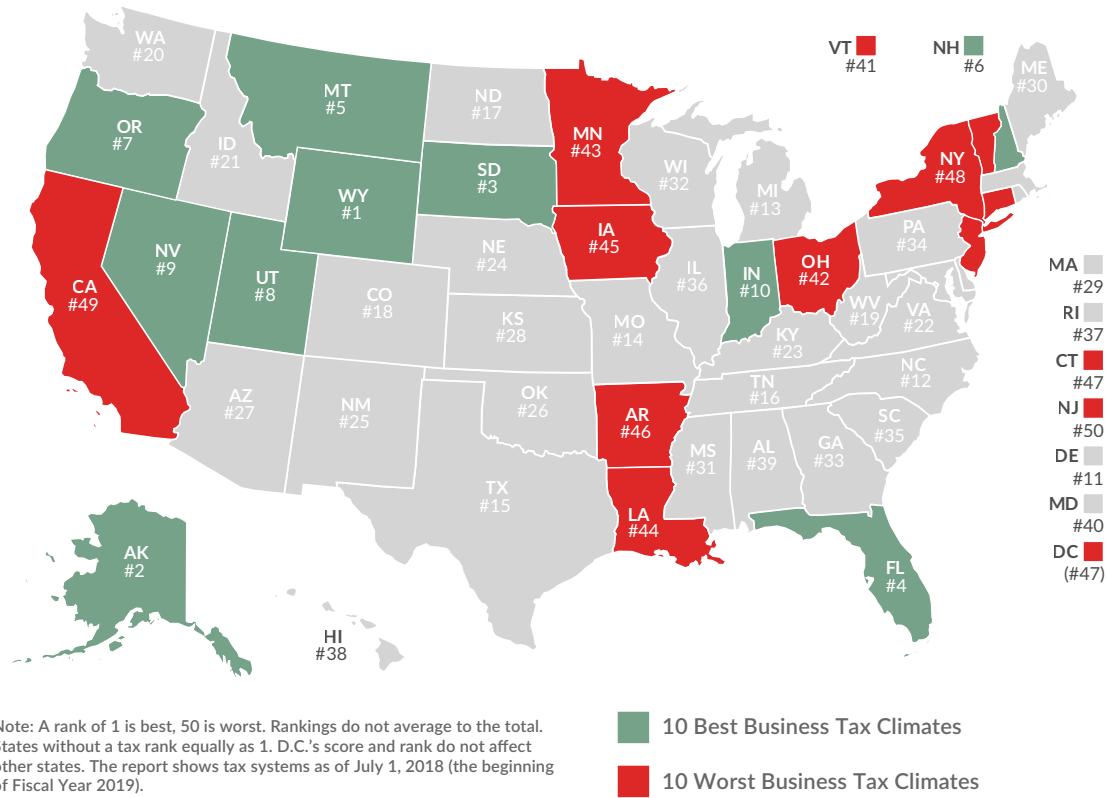
Tax reform can deliver several positive outcomes; for example, it can improve the budgeting process, making budgeting easier and more consistent, and it can reduce compliance costs for individuals and businesses. Most importantly, though, tax reform can improve a state's competitiveness.

While how much is paid in taxes each year is an important consideration for competitiveness, it is also important to consider *how* those taxes are paid. Taxes vary significantly, with certain levies being more harmful to growth or creating significant compliance costs.

Each year, the Tax Foundation produces the *State Business Tax Climate Index* to enable business leaders, state policymakers, and taxpayers to gauge how these structural elements compare. The *Index* examines more than 100 variables in individual income tax, corporate income tax, sales tax, unemployment insurance tax, and property tax categories to produce a ranking from these many complex considerations.

In the most recent 2019 edition (Figure 2h), which gauges states as of July 1, 2018, those with the most competitive tax systems are Wyoming, Alaska, South Dakota, Florida, Montana, New Hampshire, Oregon, Utah, Nevada, and Indiana. The states with the least competitive tax systems are New Jersey, California, New York, Connecticut, Arkansas, Iowa, Louisiana, Minnesota, Ohio, and Vermont.

FIGURE 2h.
2019 State Business Tax Climate Index



Wisconsin's overall tax structure ranks 32nd among states, leaving much to be desired. The worst performing major tax in the state's system is the individual income tax, which ranks 39th in the country, chiefly due to its high top marginal rate of 7.65 percent. Wisconsin's unemployment insurance tax also ranks poorly (41st), due to its high rates and overly complex structure.

TABLE 2A.
Wisconsin Component Rankings in the 2019 State Business Tax Climate Index

Component	Rank
Overall Rank	32
Corporate Taxes	35
Individual Taxes	39
Sales Taxes	8
Property Taxes	21
Unemployment Insurance Taxes	41

Another component that contributes to Wisconsin's poor *Index* rankings is the top statutory corporate income tax rate of 7.9 percent. Though lower than neighboring Illinois's rate, Wisconsin's corporate rate remains among the highest nationally. Wisconsin's overall corporate income tax structure ranks 35th on the *Index*.

Fundamental tax reform provides an opportunity to improve these shortcomings so Wisconsin can collect the revenue necessary for government services while maintaining a competitive position that allows the state to attract new businesses and individuals.

Throughout this book, we use the *State Tax Business Climate Index* to show how Wisconsin currently compares to its neighbors in terms of competitiveness in each of the major tax types: individual, corporate, sales, property, and unemployment insurance taxes. We also use the *Index* to show how different reform options would improve Wisconsin's *Index* rankings from where they stand under the existing tax code.

A photograph of a grand, multi-story brick building with a prominent arched entrance. The entrance has a balcony with a decorative railing and the words "GRAND OPERA HOUSE" written on it. There are several windows, some with arched tops, and a set of stairs leading up to the entrance. A street lamp stands in front of the building. The entire image is overlaid with a semi-transparent green filter.

CHAPTER 3

**INDIVIDUAL INCOME
TAXES**

Introduction

Of the major components of Wisconsin's tax system, the individual income tax is one of the most poorly structured, ranking 39th on our *State Business Tax Climate Index*.³⁵

Wisconsin's individual income tax has a graduated-rate structure, with four brackets levying different rates on different levels of marginal income. At 7.65 percent, Wisconsin's top marginal individual income tax rate is higher than the top rates in all but eight states and the District of Columbia.³⁶ In addition, Wisconsin's individual income tax brackets and standard deduction are structured such that married taxpayers filing jointly face higher tax burdens than single individuals with the same combined income, resulting in a marriage penalty.

In fiscal year 2016, Wisconsin's individual income tax generated nearly \$7.5 billion for the state, accounting for 42.5 percent of Wisconsin's total state tax collections, higher than the 37 percent national average.³⁷

Individual income taxes are not, of course, exclusively of interest to individual taxpayers, as "pass-through" businesses, including sole proprietorships, partnerships, limited liability companies (LLCs), and S corporations pay taxes on their business profits under the individual income tax code. Since these taxes impact Wisconsin employers, it is important to consider impacts on businesses as well as individual payers when contemplating changes to the individual tax code.

In this chapter, we provide a broad overview of Wisconsin's individual income tax, outline issues with the current system, and discuss potential reform options.

A Brief History of Wisconsin's Individual Income Tax

In 1911, Wisconsin became the first state to adopt and successfully retain an individual income tax, doing so even before the federal individual income tax was established in 1913.³⁸ Before 1911, 16 states attempted to tax income but were unable to generate significant revenue from the tax due to enforcement difficulties. Wisconsin's individual income tax, however, was initially characterized less as a source of new revenue and more as a means to reduce property taxes on farmers.³⁹

Prior to adopting an individual income tax, Wisconsin relied almost exclusively on property taxes, in accordance with the system of taxation established in the Wisconsin Constitution. Wisconsin's property tax included both real property (such as land,

35 Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, *2019 State Business Tax Climate Index*, Tax Foundation, Sept. 26, 2018, 3, <https://taxfoundation.org/publications/state-business-tax-climate-index/>.

36 Morgan Scarboro, *Facts and Figures 2018: How Does Your State Compare?* Tax Foundation, March 21, 2018, Table 12, <https://taxfoundation.org/facts-figures-2018/>.

37 U.S. Census Bureau, "2016 State & Local Government Finance Historical Datasets and Tables," <https://www.census.gov/data/datasets/2016/econ/local/public-use-datasets.html>.

38 Scott Drenkard and Richard Borean, "When Did Your State Adopt Its Income Tax?" Tax Foundation, June 10, 2014, <https://taxfoundation.org/when-did-your-state-adopt-its-income-tax/>.

39 Wisconsin Historical Society, "Wisconsin Income Tax is 100 Years Old," accessed Nov. 8, 2018, <https://www.wisconsinhistory.org/Records/Article/CS322>.

buildings, and fixtures) and tangible personal property (assets that can be touched and moved, such as furniture and appliances). However, taxes on movable assets proved unpopular and easy to evade, so proponents of the individual income tax presented it as a more viable alternative to the existing system.⁴⁰

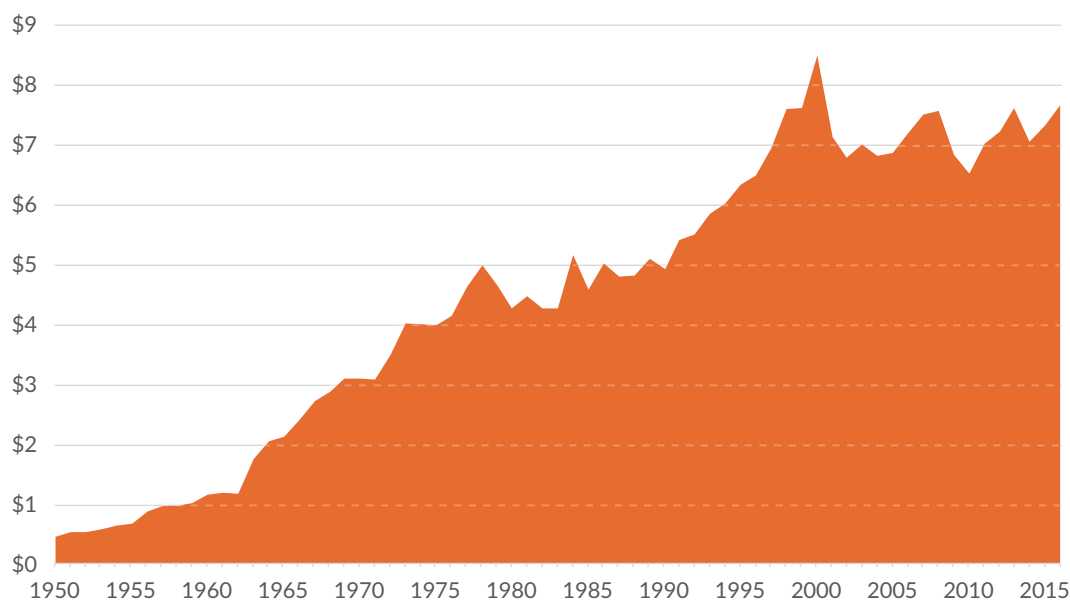
While the Wisconsin Constitution established strong parameters for uniform application of the property tax (the Uniformity Clause⁴¹) to prevent different classes of property from being assessed or taxed at different rates or assessment ratios, the individual income tax was structured as a progressive tax from the outset. Wisconsin's individual income tax has seen numerous significant changes since its inception, but it has never departed from its progressive structure and remains one of the most progressive individual income taxes in the U.S.

Wisconsin's Individual Income Tax Collections: Then and Now

Wisconsin's individual income tax collections have grown significantly over time but have seen sizable swings, dipping notably during recessionary periods (Figure 3a). In real terms, Wisconsin's individual income tax generates approximately seven times more revenue today than it did in 1960.⁴²

FIGURE 3a.

Wisconsin Individual Income Tax Collections, 1950-2016 (Billions of 2017 Dollars)



Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2017 base year.

Source: U.S. Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

40 Kossuth Kent Kennan, "The Wisconsin Income Tax," in *The Annals of the American Academy of Political and Social Science* 58 (March 1915): 65-76, <http://www.jstor.org/stable/1012848>.

41 Article VIII, section 1 of the Wisconsin Constitution.

42 See U.S. Census Bureau, "2016 State & Local Government Finance Historical Datasets and Tables."

While collections grew during the early decades of Wisconsin's individual income tax, they began to skyrocket starting in 1963. This spike in collections occurred for a combination of reasons, including rapid population growth, a growing economy, and individual income tax rate increases in 1962, 1971, and 1972.⁴³ In addition, Wisconsin's individual income tax brackets were not yet indexed for inflation, and high rates of inflation pushed taxpayers into higher-than-usual tax brackets, even without increases in real income, a concept known as "bracket creep." During the 1960s and 1970s alone, collections quadrupled (in real terms).

Collections briefly dropped in 1979, when the state's 16 income tax brackets were consolidated into eight as part of a tax reform and reduction law spearheaded by Governor Lee Sherman Dreyfus (R). In 1980, the state's individual income tax brackets were indexed for inflation for the first time, stabilizing collections. In addition, a "double-dip" recession occurred in 1980 and 1981-1982, slowing collections growth.⁴⁴

From 1983 until 2001, indexing was again suspended, and bracket creep contributed to another sharp increase in real collections, which nearly doubled during the 1980s and 1990s alone. In the middle of that period, the Tax Reform Act of 1986 broadened the federal individual income tax base and lowered rates. Wisconsin adopted many of the federal base-broadening reforms into its own tax code, which enabled the state to lower its own individual income tax rates even while collections continued to increase.⁴⁵

Shortly before the turn of the century, Wisconsin's individual income tax collections reached an all-time high, but during the tenure of Governor Tommy Thompson (R), the 1997-1999 budget consolidated four brackets into three, reduced rates, created a deduction for higher education tuition expenses, and conformed to new federal provisions, including the new Roth IRA. As a result, Wisconsin's individual income tax collections again declined.

The 1999-2001 legislative session brought further tax changes, including an increase in the standard deduction, the creation of personal exemptions, the addition of a fourth bracket, the indexing of brackets for inflation, and a reduction in rates, which led to further collections reductions.

Within the past decade, several additional policy changes have impacted the state's individual income tax collections. In 2008, during Governor Jim Doyle's (D) second term, the state stopped taxing Social Security benefits. The 2008-2009 recession saw revenue decline, so in response, lawmakers added a new top bracket at a rate of 7.75 percent, increasing collections. In 2013, during Governor Scott Walker's (R) first term, all marginal rates were reduced, and five brackets were consolidated into the current four, with a top rate of 7.65 percent.

43 *The Wisconsin Taxpayer*, "One Hundred Years and Counting: Wisconsin's Income Tax: History, Process, and Filers" 84, no. 3 (March 2016): 4, https://wispolicyforum.org/wp-content/uploads/2018/07/1603_State-Income-Tax.pdf.

44 *Ibid.*

45 *Ibid.*

Today, the individual income tax accounts for a substantial share of Wisconsin's tax revenue, generating 42.5 percent of total state tax collections in 2016, more than the general sales tax and corporate income tax combined. Wisconsin's reliance on its individual income tax is high compared to other states; on average, state individual income taxes generate only about 37 percent of total state tax collections.⁴⁶

Comparing Wisconsin's Individual Income Tax Structure to Regional and National Competitors

Wisconsin's individual income tax system ranks 39th on the individual income tax component of our *State Business Tax Climate Index*, signaling much room for improvement in terms of rates and structure. While Iowa and Minnesota rank even lower than Wisconsin due to higher top rates and worse structures, several of Wisconsin's regional competitors rank significantly better on individual income taxes, including Michigan (12th), Illinois (13th), and Indiana (15th).

TABLE 3a.
State Business Tax Climate Index
Individual Income Tax Component Rankings

Wisconsin and Select Regional Competitors (2019)

State	Component Ranking
Wisconsin	39th
Illinois	13th
Indiana	15th
Iowa	42nd
Michigan	12th
Minnesota	46th

Source: Tax Foundation, 2019 *State Business Tax Climate Index*.

Illinois, Michigan, and Indiana each have a well-structured flat individual income tax, with low rates of 4.95 percent, 4.25 percent, and 3.23 percent, respectively. (While Illinois has a flat individual income tax rate of 4.95 percent, the state imposes a 1.5 percent surtax on business income, bringing the rate to 6.45 percent for owners of pass-through businesses.)

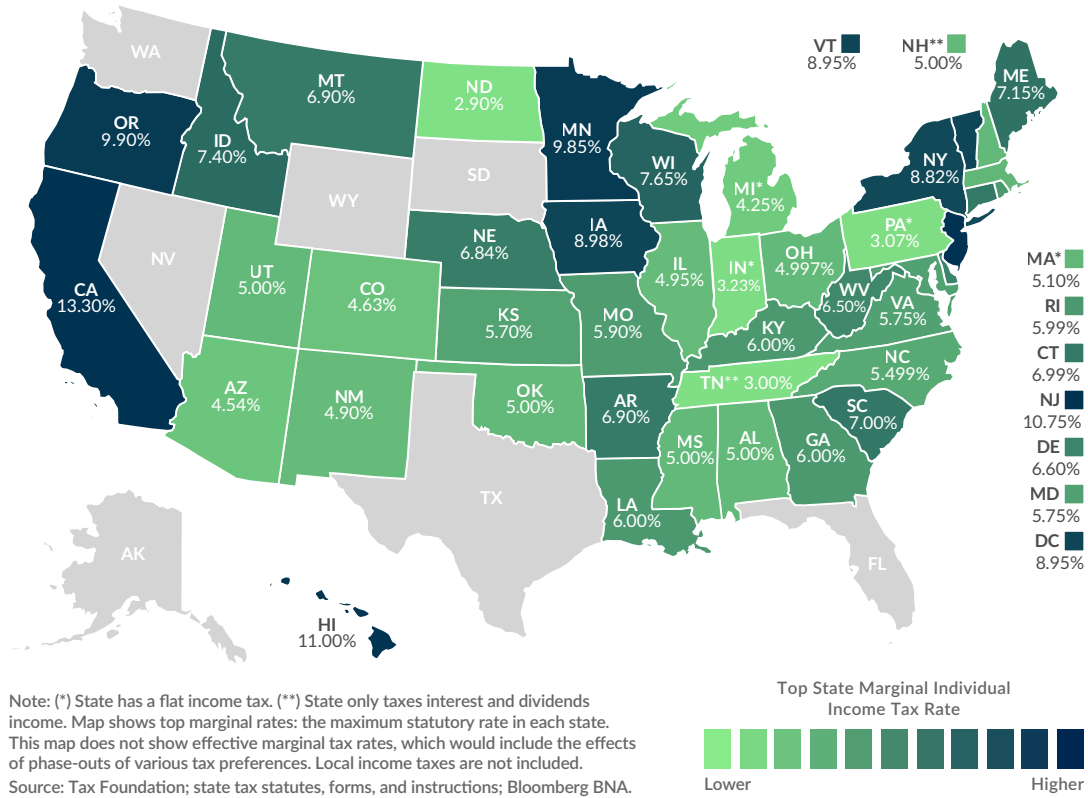
Wisconsin's four-bracket graduated-rate tax stands in sharp contrast to the low, flat rates in Illinois, Indiana, and Michigan. At 7.65 percent, Wisconsin's top marginal individual income tax rate is higher than the top rates in all but eight states (California, Hawaii, New Jersey, Oregon, Minnesota, Vermont, Iowa, and New York) and the District of Columbia.⁴⁷ Figure 3b shows the top individual income tax rate in each state.

46 See U.S. Census Bureau, "2016 State & Local Government Finance Historical Datasets and Tables."

47 Morgan Scarboro, *Facts and Figures 2018: How Does Your State Compare?* Table 12.

FIGURE 3b.

Top State Marginal Individual Income Tax Rates, 2018



Wisconsin’s four-bracket, graduated-rate income tax is currently levied at rates of 4 percent, 5.84 percent, 6.27 percent, and 7.65 percent. Table 3b shows Wisconsin’s individual income tax rate schedules for single filers and married couples filing jointly.

TABLE 3b. Individual Income Tax Rates (Tax Year 2018)

Single Filers		Married Filing Jointly	
Taxable Income	Rate	Taxable Income	Rate
\$0+	4.00%	\$0+	4.00%
\$11,450+	5.84%	\$15,270+	5.84%
\$22,900+	6.27%	\$30,540+	6.27%
\$252,150+	7.65%	\$336,200+	7.65%

Source: Wisconsin Department of Revenue.

Wisconsin’s income tax brackets are structured such that taxpayers whose taxable income falls entirely within the 4 percent bracket are taxed at a lower rate than they would be with the same amount of taxable income in most other states. However, compared to other states, Wisconsin’s rates increase quickly with increases in marginal income.⁴⁸ Wisconsin’s rates and bracket widths are structured such that most middle- and high-income taxpayers pay more in income taxes to Wisconsin than they would with the same amount of taxable income in most other states.

In fact, the second-lowest rate in Wisconsin's graduated-rate income tax (5.84 percent) is higher than the *top* income tax rate in 20 of the states that have an income tax.⁴⁹

Wisconsin's income tax is even more progressive than the rate structure shows. The state provides a number of other provisions which serve to lower the tax burden for low- and middle- income filers, such as an earned income tax credit (EITC). In fact, according to a report from the Institute on Taxation and Economic Policy (ITEP), Wisconsin ranks in the top 20 of states for its progressivity.⁵⁰ Excessive taxes on income discourage wealth creation and are therefore generally less desirable than taxes on consumption. In a comprehensive review of international econometric tax studies, Arnold et al. (2011) found that individual income taxes are among the most detrimental to economic growth, outstripped only by corporate income taxes. The authors found that consumption and property taxes are the least harmful.⁵¹

The economic literature on graduated-rate income taxes is particularly unfavorable.⁵² The Arnold et al. study concluded that reductions in top marginal rates would be beneficial to long-term growth, and Mullen and Williams (1994) found that higher marginal tax rates reduce gross state product growth. This finding even adjusts for the overall tax burden of the state, lending credence to the precept of broad bases and low rates.⁵³

Structural Elements

In addition to having high individual income tax rates compared to regional and national competitors, Wisconsin's income tax contains several additional features that hurt the state's competitiveness and warrant reexamination and improvement.

Marriage Penalty

An ideal individual income tax structure doubles bracket widths for married couples filing jointly to ensure that they do not face higher burdens than they would if filing separately. As can be seen in Table 3b (previous page), however, Wisconsin's marginal income thresholds are only about 33 percent higher for married couples filing jointly than they are for single filers, resulting in a substantial marriage penalty.

In addition to having significant tax implications for households, marriage penalties carry serious ramifications for pass-through businesses. The top quintile of income earners is dominated (85 percent) by married couples, and this same quintile also has the highest

49 Morgan Scarboro, *Facts and Figures 2018: How Does Your State Compare?* Tax Foundation, Table 12.

50 The Institute on Taxation and Economic Policy (ITEP) ranks Wisconsin 34th in its "Tax Inequality Index," with 1 representing the least equitable state and 51 representing the most equitable state. This means Wisconsin ranks in the top third of states for equitable tax treatment, according to ITEP's ranking. ITEP's Tax Inequality Index measures the effects "of each state's tax system on income inequality," asking one simple question: "Are incomes more or less equal after state taxes than before taxes?" For more on ITEP's ranking, see Meg Weihe, Aidan Davis, Carl Davis, Matt Gardner, Lisa Christensen Gee, and Dylan Grundman, "Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, 6th Edition," Institute on Taxation and Economic Policy, October 2018, <https://itep.org/wp-content/uploads/whopays-ITEP-2018.pdf>.

51 Jens Arnold, Bert Brys, Christopher Heady, Åsa Johannsson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy for Economic Recovery and Growth," *The Economic Journal* 121, no. 550 (February 2011).

52 See William McBride, "What is the Evidence on Taxes and Growth?" Tax Foundation, Dec. 18, 2012, <https://taxfoundation.org/what-evidence-taxes-and-growth>.

53 John K. Mullen and Martin Williams, "Marginal Tax Rates and State Economic Growth," *Regional Science and Urban Economics* 24, no. 6 (December 1994).

concentration of business owners of all income groups.⁵⁴ Therefore, marriage penalties have the potential to affect a significant share of pass-through businesses. Wisconsin is one of only 15 states with a marriage penalty.⁵⁵

In an attempt to abate this marriage penalty, Wisconsin offers a “married couple credit” available to married couples filing jointly when both spouses are employed. The married couple credit is available at a rate of 3 percent of qualified earned income, up to a maximum credit of \$480. In most cases, the married couple credit is enough to offset the impact of the disparity in bracket widths, but it is not a perfect fix.

There are some instances in which the credit is insufficient to negate the impact of the marriage penalty. This is most likely to be the case when two married taxpayers have high incomes, widely disparate incomes, or a significant amount of business income. There are also plenty of instances in which the married couple credit overcompensates for the disparity in bracket widths, resulting in a de facto marriage bonus. A more neutral and transparent system would simply double the bracket widths for married couples filing jointly.

Standard Deduction

Unlike most states that offer a uniform standard deduction regardless of income, Wisconsin has a sliding-scale standard deduction that is available only to taxpayers with taxable income below a specified amount. Even within the eligibility range, Wisconsin’s standard deduction is distinctly progressive, phasing out with increases in income.

In tax year 2018, the maximum standard deduction that can be claimed is \$10,580 for single filers and \$19,580 for married couples filing jointly.⁵⁶ This amount, which is adjusted annually for inflation, decreases quickly as income rises. Specifically, in tax year 2018, the standard deduction begins to phase out for single taxpayers with over \$15,500 in Wisconsin income and married couples with over \$22,000 in Wisconsin income. Taxpayers with Wisconsin income above a certain amount (\$103,500 for single filers and \$121,009 for married couples filing jointly) are not eligible to claim a standard deduction at all. Due to this sliding-scale feature, Wisconsin’s standard deduction can hardly be considered “standard” at all, as the actual deduction claimed varies from taxpayer to taxpayer and from one tax year to the next.

Like the state’s income tax bracket widths, Wisconsin’s standard deduction contains a marriage penalty, meaning married taxpayers generally receive a smaller standard deduction than they would if filing as two single individuals with the same amount of combined income. In the 2015-2017 biennial budget (2015 Wisconsin Act 55), Wisconsin legislators mitigated the total marriage penalty in the state’s standard deduction by

54 Scott A. Hodge, “Married Couples File Less than Half of All Tax Returns, But Pay 74 Percent of All Income Taxes,” Tax Foundation, March 25, 2003, <http://taxfoundation.org/article/married-couples-file-less-half-all-tax-returns-pay-74-percent-all-income-taxes>; Scott A. Hodge, “Own a Business? You May Be Rich: Two-Thirds of Taxpayers Hit by Highest Tax Rate Have Business Income,” Tax Foundation, May 5, 2003, <http://taxfoundation.org/article/own-business-you-may-be-rich-two-thirds-taxpayers-hit-highest-tax-rate-have-business-income>.

55 Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, 2019 *State Business Tax Climate Index*, Tax Foundation, 67.

56 See “2018 Standard Deduction Table,” Wisconsin Income Tax, Form 1 Instructions, 55, <https://www.revenue.wi.gov/TaxForms2017through2019/2018-Form1-inst.pdf>.

\$20.9 million annually.⁵⁷ Specifically, for married couples filing jointly and married taxpayers filing separately, this law increased the amounts that could be claimed in the standard deduction while raising the phaseout level so more married taxpayers would be eligible to claim a standard deduction.

However, some disparity still exists. Legislators should consider removing the marriage penalty altogether by offering married taxpayers double the standard deduction amount that is available to single filers. To make the tax code even simpler and more neutral, a marriage penalty fix could be accompanied by elimination of the sliding scale altogether, which would make the standard deduction available to all taxpayers. For context, as of January 1, 2018, Georgia and Kentucky are the only states besides Wisconsin that do not double their standard deduction for married filers.⁵⁸

Personal Exemption

Wisconsin offers a personal exemption of \$700 per filer, spouse, and dependent, the sum of which is subtracted from the taxpayer's Wisconsin income in determining a taxpayer's taxable income. The exemption is \$950 for each person age 65 or older. Wisconsin's personal exemption is not indexed for inflation, meaning the real value of this exemption has decreased over time. Indexing the personal exemption for inflation would help preserve the real value of the personal exemption.

Itemized Deductions Credit

Unlike in most other states, Wisconsin taxpayers do not face a choice between claiming the standard deduction and itemizing their deductions, since Wisconsin does not offer its own itemized deductions. In lieu of itemized deductions, Wisconsin offers an itemized deductions credit, worth up to 5 percent of the amount claimed in federal deductions in four categories: certain out-of-pocket medical and dental expenses, home mortgage interest paid, charitable contributions, and casualty losses. Taxpayers who are eligible to claim a Wisconsin standard deduction must first subtract the standard deduction from the sum of those four itemization categories before claiming the 5 percent itemized deductions credit.

The interaction between the Wisconsin standard deduction and the itemized deductions credit is unnecessarily complex. The state could achieve similar outcomes in a more neutral and transparent manner by offering a robust standard deduction with no phaseout in lieu of the itemized deductions credit.

57 Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017, <https://www.revenue.wi.gov/DORReports/17sumrpt.pdf>.

58 Morgan Scarborough, "State Individual Income Tax Rates and Brackets for 2018," Tax Foundation, March 5, 2018, <https://taxfoundation.org/state-individual-income-tax-rates-brackets-2018/>.

Capital Gains

Wisconsin is unique in that it provides preferential treatment to capital gains. The federal government taxes capital gains at a lower rate than ordinary income, in part to account for the double layer of tax on capital gains income. Wisconsin's approach is different. Wisconsin's tax code allows a 30 percent deduction on net capital gains for assets held for more than one year when computing taxable income (for farm assets, it's 60 percent of net capital gains).⁵⁹ This income is excluded from a taxpayer's capital gains tax basis.

Another way to think about this provision is that it helps ensure that an investor is taxed on their real gains, not their nominal gains. While 30 percent is a rough estimate, it helps reduce the cost of capital to investors in the state.⁶⁰

On the other hand, Wisconsin limits the ability of taxpayers to deduct their capital losses. The federal government allows investors to deduct \$3,000 in capital losses per year (with a carryforward), but Wisconsin limits this to \$500 per year (with a carryforward).⁶¹ Ideally, the tax code would allow investors to fully capture their capital losses to ensure the tax code only taxes their actual income, not an inflated paper income.⁶²

This treatment of losses creates an asymmetry in the tax treatment. Capital gains are subject to tax when they are realized, while losses do not provide an equal tax benefit. This is exacerbated by the fact that the capital losses, while allowed to be carried forward, lose value over time. A \$500 deduction 10 years from now is far less valuable than a \$500 deduction this year.⁶³

Pass-Through Businesses Pay Individual Income Taxes

Individual income taxes are of considerable importance to pass-through entities, businesses that pay the individual income tax in lieu of the corporate income tax because the earnings "pass through" to the income tax form of the owners or shareholders rather than being remitted by the business entity itself. Because sole proprietorships, partnerships, limited liability companies (LLCs), and S corporations remit their income tax payments through the individual income tax, the individual code is a significant policy issue for most Wisconsin businesses.⁶⁴ Figure 3c shows the share of employer firms in each sector that pay individual income taxes in Wisconsin (separated by pass-through business type).⁶⁵

59 Wisconsin Department of Revenue, "Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, and Trusts," Publication 103, January 2019, <https://www.revenue.wi.gov/DOR%20Publications/pb103.pdf>.

60 Stephen J. Entin, "Getting 'Real' by Indexing Capital Gains for Inflation," Tax Foundation, March 6, 2018, <https://taxfoundation.org/inflation-adjusting-capital-gains/>.

61 Wisconsin Department of Revenue, "Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, and Trusts."

62 Kyle Pomerleau, "Testimony: The Tax Code as a Barrier to Entrepreneurship," Tax Foundation, Feb. 15, 2017, <https://taxfoundation.org/tax-code-barrier-entrepreneurship/>.

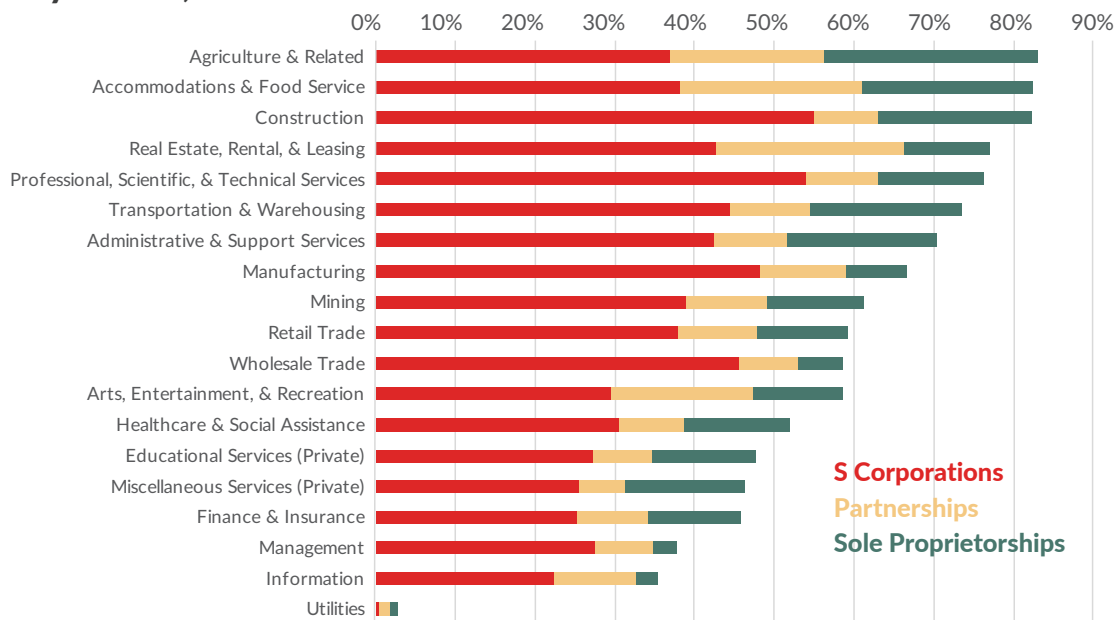
63 Ibid.

64 The issue is also a significant one for companies throughout the U.S. Over the past 30 years, the pass-through business sector has expanded significantly. Now, a majority of companies in the U.S. are pass-through businesses. See generally, Scott Greenberg, "Pass-Through Business: Data and Policy," Tax Foundation, Jan. 17, 2017, <https://taxfoundation.org/pass-through-businesses-data-and-policy/>.

65 U.S. Census Bureau, County Business Patterns, "Geographic Area Series: County Business Patterns by Legal Form of Organization," 2016.

FIGURE 3c.

Share of Employer Firms Paying the Individual Income Tax, By Sector, 2016



Source: Census Bureau, 2016 County Business Patterns.

While individual income taxes directly impact pass-through businesses, traditional C corporations care about these taxes as well, since high rates can impede their ability to attract and retain talented employees.

Individual Income Tax Reform Solutions

Our individual income tax reform solutions improve the tax code by consolidating brackets, reducing rates, and fixing the marriage penalty. These solutions will make the state more competitive with its neighbors, more attractive to prospective residents and employers, and more neutral in its application.

We have included four options for policymakers to consider. When paired with the other reforms outlined in the Executive Summary, each plan is roughly revenue neutral, although rates could be dialed up or down according to revenue needs.

All of our reform solutions reduce rates, consolidate brackets, and fix the marriage penalty. The following sections highlight the differences that exist among the four options.

Individual Income Tax Option A

Option A transitions the four-bracket, graduated-rate individual income tax to a flat tax with a rate of 4.82 percent. Under this plan, Wisconsin's rate would be lower than Illinois's flat rate of 4.95 percent and more competitive with the rates in Indiana (3.23 percent) and Michigan (4.25 percent).

In addition, Option A conforms to the federal standard deduction (set at \$12,000 for single filers and \$24,000 for married filers in Tax Year 2018, adjusted annually for inflation). As such, Wisconsin's standard deduction would be available to all Wisconsinites, without a complicated phaseout schedule or the marriage penalty that exists under current law. With a standard deduction that is available to all taxpayers, the state would have less reason to maintain its personal exemption or complicated itemized deductions credit, both of which would be repealed under this plan.

Individual Income Tax Option B

Option B restructures Wisconsin's individual income tax to make it similar to the fast-growing states in the southeastern U.S., with lower marginal rates and less progressivity in bracket structure. While not a flat tax, the tax structure in Option B moves away from penalizing marginal increases in income.

Specifically, Option B consolidates Wisconsin's four brackets into three while reducing rates and lowering marginal income thresholds, such that rates of 4 percent, 5 percent, and 6.8 percent are applied to income thresholds of \$0, \$10,000, and \$40,000.

Like Option A, Option B conforms to the federal standard deduction while repealing the personal exemption and itemized deductions credit.

The rate schedule for Option B is below.

TABLE 3c. OPTION B.
Individual Income Tax Rate Schedule

Single Filers		Married Filing Jointly	
Taxable Income	Rate	Taxable Income	Rate
\$0+	4%	\$0+	4%
\$10,000+	5%	\$20,000+	5%
\$40,000+	6.80%	\$80,000+	6.80%

Individual Income Tax Option C

Option C, like Option A and Option B, conforms to the federal standard deduction of \$12,200 for single filers and \$24,400 for married couples, and repeals both the personal exemption and itemized deductions credit. Option C also retains the rate structure of Option B by consolidating Wisconsin's four brackets into three, and lowering marginal income thresholds. Like Option B, rates of 4 percent, 5 percent, and 6.8 percent are applied to income thresholds of \$0, \$10,000, and \$40,000.

In effect, Option C's personal income tax reforms are identical to Option B. Option C's reforms focus more heavily on the Badger State's corporate income tax.

Individual Income Tax Option D

Option D retains the progressivity of the existing system while taking steps to promote economic growth and competitiveness. Specifically, this plan consolidates four brackets into three, essentially collapsing Wisconsin's second and third brackets into a wider bracket at a lower rate. Option D also reduces the top rate slightly, from 7.65 percent to 7.5 percent.

Option D retains the existing progressive sliding-scale standard deduction and phase-out schedule, but it eliminates the marriage penalty in the standard deduction by allowing married couples to claim double the amount, at every income level, that is available to single filers. Option D retains the personal exemption as it exists under current law, but it repeals the itemized deductions credit.

The rate schedule for Option D is below.

TABLE 3d. OPTION D.
Individual Income Tax Rate Schedule

Single Filers		Married Filing Jointly	
Taxable Income	Rate	Taxable Income	Rate
\$0+	4%	\$0+	4%
\$20,000+	5%	\$40,000+	5%
\$150,000+	7.50%	\$300,000+	7.50%

Impact of Individual Income Tax Solutions on Real People

The chart below shows how individual taxpayers would be impacted by the individual income tax reform solutions offered in Options A, B, C, and D. Most taxpayers would receive a net income tax cut under each tax reform option.

How Wisconsin Tax Reform Options Affect Real People (State Income Tax Liability)

	Current Wisconsin Tax System	Option A	Option B	Option C	Option D
 Abigail One child Income: \$15,000 Filing Status: Head of Household	-\$138*	-\$138*	-\$138*	-\$138*	-\$138*
 Patrick & Samantha Retired no children Income: \$36,000 Filing Status: Married Filing Jointly	\$0	\$0	\$0	\$0	\$0
 Daniel Single no children Income: \$50,000 Filing Status: Single	\$2,296	\$1,832	\$1,800	\$1,800	\$1,946
 Jason & Nicole Two children Income: \$75,000 Filing Status: Married Filing Jointly	\$3,547	\$2,458	\$2,350	\$2,350	\$2,872
 Monique Single no children Income: \$100,000 Filing Status: Single	\$5,893	\$4,242	\$5,164	\$5,164	\$4,746
 Peter & Kelsey Two children Income: \$150,000 Filing Status: Married Filing Jointly	\$8,791	\$6,073	\$6,928	\$6,928	\$6,960

*Liability is negative depending on Earned Income Tax Credit (EITC) eligibility; for ineligible taxpayers at that income level, tax liability is \$0. Options as prepared do not adjust Wisconsin EITC (4% of federal if one child, 11% of federal if two children, 34% of federal if three or more children).

Source: Tax Foundation calculations using data from Internal Revenue Service and Wisconsin Department of Revenue. Excludes federal tax liability and share of state corporate income tax reduction. Estimates are static analysis that assumes no immediate economic growth from tax changes. Assumes head of household standard deduction matches federal (\$18,000).



CHAPTER 4

**CORPORATE INCOME
TAXES**

Introduction

At 7.9 percent, Wisconsin's corporate income tax rate ranks high nationally despite being in the middle of the pack compared to neighboring states.

To ameliorate some of the high statutory tax burden, Wisconsin relies heavily on corporate tax credits and deductions. In many states, such incentives mitigate tax burdens for select industries and activities but put upward pressure on the overall rate.

While many states have reduced their reliance on corporate taxes in recent years due to their revenue volatility and detrimental impact on business investment, not once since the inception of Wisconsin's corporate income tax has the rate been reduced. As such, the state has the opportunity to improve its attractiveness to business investment of all types by moving toward a system with a broader base and lower rates.

In this chapter, we provide a broad overview of Wisconsin's corporate income tax, outline issues to consider regarding the current system, and provide options for reform.

Overview of Wisconsin's Corporate Income Taxation

The Badger State was the first state to enact a corporate income tax, creating a corporate income tax and an individual income tax at the same time in 1911 under the Wisconsin Income Tax Law.⁶⁶ Wisconsin's corporate income tax was originally imposed with rates ranging from 2 to 6 percent, though today it uses just one flat rate, albeit a higher one of 7.9 percent (Table 4a).

TABLE 4a.
Wisconsin Corporate Tax Rates, 1913-Present

Bracket	1913-1953	1954-1970	1971	1971-1980	1981-Present
\$0-1,000	2%	2%	2.1%	2.3%	7.9%
\$1,001 - \$2,000	2.5%	2.5%	2.7%	2.8%	7.9%
\$2,001 - \$3,000	3%	3%	3.2%	3.4%	7.9%
\$3,001 - \$4,000	3.5%	4%	4.3%	4.5%	7.9%
\$4,001 - \$5,000	4%	5%	5.3%	5.6%	7.9%
\$5,001 - \$6,000	5%	6%	6.4%	6.8%	7.9%
\$5,001 - above	6%	7%	7.4%	7.9%	7.9%

Source: Wisconsin Department of Revenue.

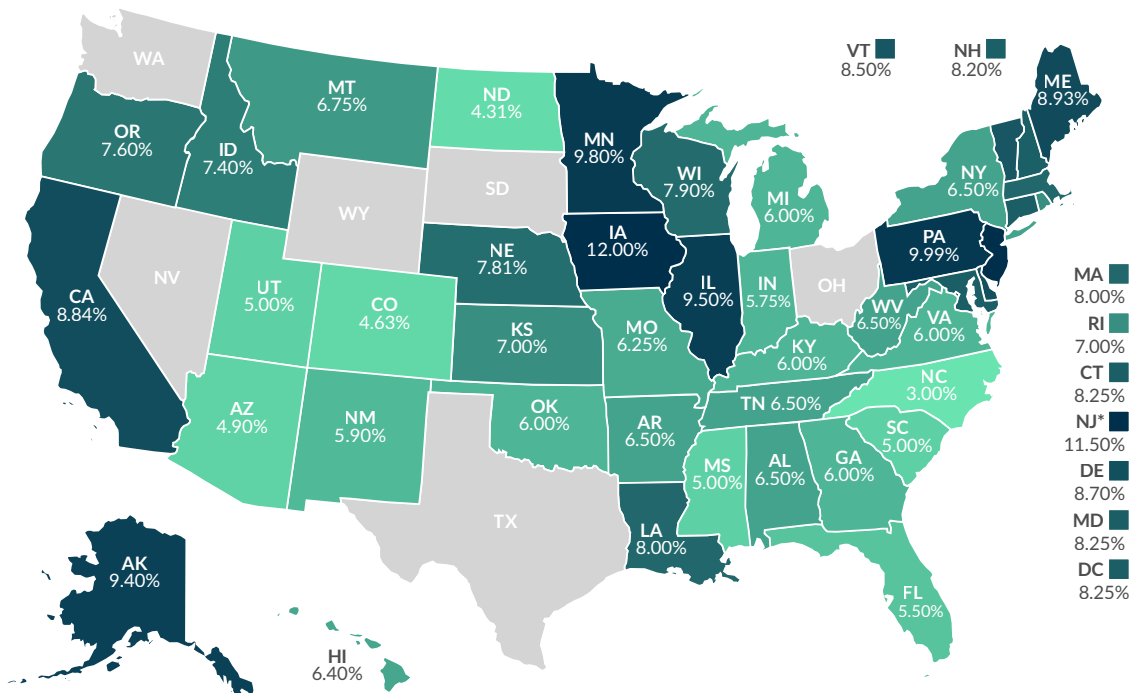
66 Liz Emanuel and Richard Borean, "When Did Your State Adopt Its Corporate Income Tax?" Tax Foundation, June 19, 2014, <https://taxfoundation.org/when-did-your-state-adopt-its-corporate-income-tax/>; Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," Wisconsin Department of Revenue, Division of Research and Policy, June 18, 2018, 20, <https://www.revenue.wi.gov/DORReports/CorplncFranchTax.pdf>, and Kossuth Kent Kennan, "The Wisconsin Income Tax," *The Quarterly Journal of Economics* 26, no. 1, November 1911, 169-78, <https://www.jstor.org/stable/1884532>.

Wisconsin's corporate tax rate is in the middle of the pack compared to its neighbors, with Iowa, Minnesota, and Illinois having higher top rates of 12.0 percent, 9.8 percent, and 9.5 percent, respectively, but with Indiana and Michigan featuring lower top rates of 6 percent and 5.75 percent, respectively (Figure 1a). Nationally, Wisconsin's 7.9 percent rate is on the high side, with just 15 states and D.C. topping out at higher rates, and many of those states being home to sizable cities with legacy corporate capital formation.

Notably, Wisconsin additionally levies an "Economic Development Surcharge" of 3 percent of gross tax liability on firms with gross receipts above \$4 million. The surcharge is capped at \$9,800.⁶⁷

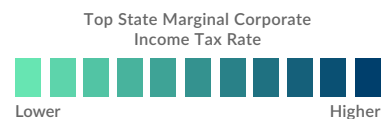
FIGURE 4a.

Top Marginal Corporate Income Tax Rates as of July 1, 2018



Note: (*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Arkansas has a "benefit recapture," by which corporations with more than \$100,000 of taxable income pay a flat tax of 6.5% on all income, not just on amounts above the benefit threshold. Connecticut's rate includes a 10% surtax, which effectively increases the rate from 7.5% to 8.25%. Surtax is required by businesses with at least \$100 million annual gross income. Illinois' rate includes two separate corporate income taxes, one at a 7.0% rate and one at a 2.5% rate.

Source: State tax statutes, forms, and instructions; Bloomberg BNA.



Forty-four states levy a corporate income tax, most with flat rate structures like Wisconsin's. Since 2008, 15 states and the District of Columbia have cut corporate income tax rates, and Michigan shifted from a gross receipts tax to a traditional corporate income tax.⁶⁸ In Wisconsin, by contrast, corporate income taxes have never been cut in the history of the tax; the current top rate has been the same since 1971, when the top marginal rate was first raised to 7.9 percent.⁶⁹

67 Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," 8. Revenues from the surcharge fund programs of the Wisconsin Economic Development Corporation (WEDC).

68 See Joseph Bishop-Henchman, "Trend #3: Corporate Tax Reductions, Top 10 State Tax Trends in Recession and Recovery, 2008 to 2012," Tax Foundation, June 13, 2012, <http://taxfoundation.org/article/trend-3-corporate-tax-reductions>; *Facts & Figures: How Does Your State Compare?* Tax Foundation, multiple years.

69 Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," 20.

Reductions in corporate rates elsewhere reflect a trend toward decreased reliance on a highly volatile tax imposed on a declining amount of taxable income, and, in some instances, an effort to simplify the tax structure by broadening the base and lowering the rate. Corporate income tax reliance is also in decline across the country as more businesses choose to structure as S corporations and limited liability corporations (LLCs), single sales factor apportionment becomes more common, and the tax base is eroded by special credits and deductions.

Economists generally agree that corporate income taxes are not borne by businesses but are instead passed on to consumers in the form of higher prices, shareholders in the form of lower dividends, or labor in the form of lower wages.⁷⁰ Corporate income taxes also tend to be complex and impose substantial administrative burdens for both payers and the government, and this complexity has not abated as the tax base has eroded. Finally, revenue volatility necessarily follows from the nature of the tax, since in periods of economic distress, many companies may post losses and thus lack exposure to a corporate income tax (as evidenced below in Wisconsin in Figure 4b).

Comparing Wisconsin's Corporate Taxes Regionally and Nationally

Wisconsin's corporate tax system ranks toward the bottom of the pack nationally in terms of competitiveness, coming in at 35th on our *State Business Tax Climate Index*, a measure of both tax rates and tax structure. Compared to its neighboring states, Wisconsin outperforms Iowa, Minnesota, and Illinois but comes in behind Michigan and Indiana (Table 4b).

TABLE 4b.
2019 State Business Tax Climate Index
Corporate Income Tax Component
Rankings, Wisconsin and Nearby States

State	Component Ranking
Illinois	39
Indiana	18
Iowa	48
Michigan	11
Minnesota	42
Wisconsin	35

Source: Tax Foundation, 2019 *State Business Tax Climate Index*.

70 See, e.g., Robert Carroll, *Corporate Taxes and Wages: Evidence from the 50 States*, TAX FOUNDATION WORKING PAPER NO. 8 (Aug. 2009), <http://taxfoundation.org/article/corporate-taxes-and-wages-evidence-50-states>. See also Stephen J. Entin, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation Special Report 238, Oct. 24, 2017, <https://taxfoundation.org/labor-bears-corporate-tax/>.

Corporate Income Tax Collections

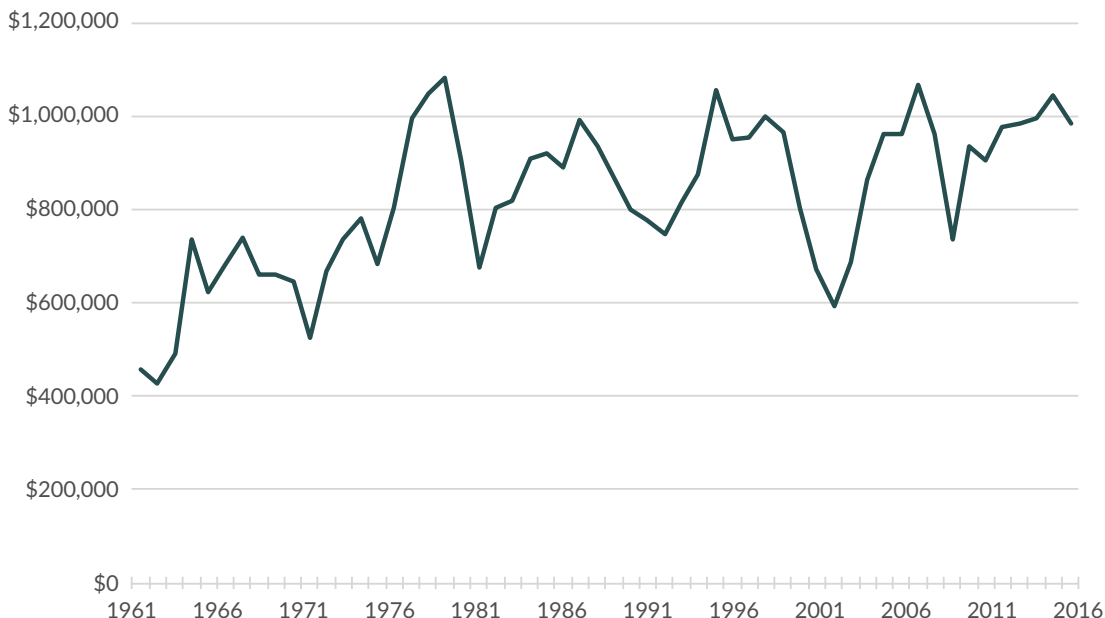
In fiscal year 2016, the corporate income tax brought in \$986 million. Wisconsin's corporate income tax collections per capita are on the high side, ranking 14th in the nation.⁷¹

Corporate income taxes are among the most volatile sources of state revenue, since many companies may generate little or no net income during economic downturns. While practically all revenue streams are cyclical, with collections lower during periods of economic distress, corporate income taxes experience particularly deep troughs. Property values may decline during a recession, but they are rarely wiped out, limiting how low property tax collections can go. Similarly, consumption patterns may decline, leading to lower sales tax revenues when the economy is slowing, but sales can only drop so far. Many companies' net income, by contrast, can bottom out or even go into negative territory. As such, corporate tax collections tend to be hyper-cyclical and highly volatile, spiking sharply in good years and collapsing in bad ones.

Figure 4b shows that Wisconsin corporate income tax collections took a significant hit during the early 2000s' recession and in the Great Recession, just at the time when Wisconsin most needed revenue stability.

FIGURE 4b.

Wisconsin Corporate Income Tax Collections, 1961–2016 (in Thousands of 2016 dollars)



Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2016 base year.

Source: Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

71 Morgan Scarborough, *Facts & Figures 2018: How Does Your State Compare?* Tax Foundation, March 21, 2018, Table 16, <https://taxfoundation.org/publications/facts-and-figures/>.

Corporate Income Tax Expenditures

Deductions, credits, and exemptions all serve to reduce tax liability, but they do so in distinct ways that are important to bear in mind while attempting any comparison. Deductions reduce taxable income by a given amount, whereas credits are a subtraction against tax liability. Imagine, for instance, a corporate taxpayer with \$50,000 in Wisconsin corporate income tax liability. A \$5,000 credit will reduce tax liability to \$45,000. A \$5,000 deduction will reduce tax liability by less than \$500, by removing the tax only on that \$5,000. An exemption, meanwhile, excludes certain revenue from the tax rolls altogether.

Wisconsin offers a range of deductions, credits, and exemptions against corporate income tax liability. By far the most significant of these are the Manufacturing and Agriculture Credit (MAC), the Enterprise Zones Jobs Credit, and the Research Expenditures Credit (see Table 4c).

The MAC provides a credit equivalent to 7.5 percent of income that is derived from agricultural or manufacturing activities.⁷² Though the credit is nonrefundable, for many firms it can be significant, potentially wiping out most corporate tax liability. The MAC is also available to other business forms like S corporations and LLCs that file returns through the individual income tax.

The Enterprise Zones Jobs Credit is administered by the Wisconsin Economic Development Corporation (WEDC). It is awarded to firms that locate within one of 30 designated geographical areas and make significant capital or labor investments in those areas. The credit is quite intricate, with five components offering tax reductions for payroll growth, job training expenses, capital expenditures, and goods and services purchased from Wisconsin vendors. Because the credit is refundable, businesses for which the credit is larger than their entire tax liability receive a check back from the Department of Revenue.⁷³

The Research Expenditures Credit is awarded to firms based on their research expenses. Firms receive a 5.75 percent credit against expenses that are above 50 percent of the firm's average research expense over the previous three years. The credit is nonrefundable.⁷⁴

The total revenue reduction from the totality of Wisconsin's nonrefundable corporate tax credits was an estimated \$125.5 million in FY 2016, and an additional \$50 million was estimated to have been spent on refundable corporate tax credits that year. For context, the corporate tax collected \$963 million that fiscal year, and so corporate tax credits together represent approximately 15 percent of Wisconsin's corporate tax base.⁷⁵

72 Ibid., 52.

73 Ibid., 48.

74 Ibid., 45-6.

75 Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017, <https://www.revenue.wi.gov/DORReports/17sumrpt.pdf>.

TABLE 4c.

Corporate Income Tax Credits in Excess of \$1 Million

Credit	Amount in FY16
Manufacturing and Agriculture Credit	\$58,000,000
Enterprise Zones Jobs Credit	\$44,400,000
Research Expenditures Credit	\$36,300,000
Supplement to Federal Historic Rehabilitation Credit	\$9,000,000
Super Research Credit Carryforward	\$8,000,000
Economic Development Credit	\$7,000,000
Jobs Tax Credit	\$4,800,000
Engine Research Expense Credit	\$3,000,000
Manufacturing Investment Credit	\$1,600,000
Development Zone and Development Opportunity Zone Credits	\$1,000,000

Source: Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017.

In our discussions around the state, it became clear to us that for many businesses, the MAC and other incentives make the 7.9 percent corporate rate tolerable. A rate that high without the MAC or something comparable would make many business activities unsustainable. That said, incentives generally are not good long-term economic development due to their inefficiencies. By lowering tax costs for targeted industries or rewarding particular business activities, they can yield higher employment or greater investment in those sectors, but that does nothing for businesses in other sectors. A well-structured tax code with a broader base—eliminating many of the incentives—and a lower rate would do far more to encourage job creation and economic growth. In Wisconsin's case, the MAC reduces business tax burdens for manufacturing and agriculture businesses while new and fledgling businesses must face the full freight of the state's high tax rates.

Policy options for tax incentives vary. The Pew Center on the States has done a very good job in recent years assisting states in defining goals for tax incentives and developing metrics to analyze effectiveness. Some states like North Carolina and Indiana have pursued large reductions or elimination of tax incentives coupled with substantial reductions in the corporate tax rate, replacing a picking-winners-and-losers-through-the-tax-code approach with a broad-based and competitive tax code for all. Indiana in particular has paired eliminations of ineffective corporate tax incentives with eliminations of ineffective individual tax incentives, while reducing both corporate and individual tax rates.

Structural Elements

Net Operating Loss Carrybacks and Carryforwards

The corporate income tax is designed to tax only the profits of a corporation. However, a yearly profit snapshot may not fully capture a corporation's true profitability. For example, a corporation in a highly cyclical industry may look very profitable during boom years but post substantial losses during bust years. When examined over the entire business cycle, the corporation may actually have only a moderate profit margin.

Although corporate income tax liability is determined on an annualized basis, business cycles do not follow the calendar. To mitigate this effect, states (along with the federal government) allow corporations to deduct losses from previous years and future years to offset current taxes owed. These net operating loss (NOL) "carrybacks" and "carryforwards" smooth out tax obligations over time, ensuring that industries with cyclical income are not at a competitive disadvantage against industries with more consistent and stable revenue streams.

The deduction for net operating losses helps ensure that, over time, the corporate income tax is a tax on average profitability. Without the NOL deduction, corporations in cyclical industries pay much higher taxes than those in stable industries, even assuming identical average profits over time.

There are two important variables of a state's NOL provisions: the number of years allowed for carrybacks and carryforwards, and caps on the amount of carrybacks and carryforwards. The maximum that any state allows for carrybacks is three years, with no cap (that is, an unlimited dollar amount allowed). Among the states that allow carrybacks, the most common time span is two years with no cap. The maximum carryforward given in any state is 20 years, again with no cap (most states allow either 15 or 20 years, though 20 is more desirable). The longer the overall time span, the higher the probability that the corporate income tax is being levied on the corporation's average profitability. Wisconsin allows 20 years of carryforwards but does not allow for any carrybacks.

The Tax Cuts and Jobs Act (TCJA) changed the way the federal government handles NOLs. Previously, the federal government allowed two years of carrybacks and 20 years of carryforwards. Under the new law, the federal government will now allow carryforwards for an unlimited number of years, but they are capped at 80 percent of tax liability in a given year. Carrybacks are no longer allowed in the federal corporate tax.⁷⁶

Wisconsin should consider adhering to this new federal standard for simplicity and conformity with the new code.

76 Jared Walczak, "Tax Reform Moves to the States: State Revenue Implications and Reform Opportunities Following Federal Tax Reform," Tax Foundation, Jan. 31, 2018, <https://taxfoundation.org/state-conformity-federal-tax-reform/>.

Apportionment and Throwback

When businesses operate in more than one state, income must be apportioned among those states for tax purposes. The legal term for whether a state has the power to tax is *nexus*, a standard which typically requires a business to have some physical presence, either property or employees, in a state. The determination of the amount of that business's income subject to a given state's corporate income tax is known as *apportionment*.

States apportion business profits based on some combination of the percentage of company property, payroll, and sales located within their borders. Traditionally, states adopted an evenly weighted three-factor apportionment formula of property, payroll, and sales, meaning that property, payroll, and sales are taken into account equally when determining income apportionment. Today, states have moved increasingly toward weighting their sales factor more heavily, with many states even employing single sales factor apportionment, meaning the only determinant of the percent of firm profits subject to tax within the state is the percent of sales into that state.

Wisconsin employs a single-sales formula for most businesses, though it occasionally employs different weighting that can include property or payroll factors for some interstate firms like pipelines and telecommunications.⁷⁷

Single-sales factor treatment is beneficial for firms that export to other states, as in-state sales are the only sales that weigh into the apportionment ratio. Additional capital improvements in a headquarters or manufacturing plant, as well as equipment located in Wisconsin, do not directly expose a company to increased Wisconsin corporate tax liability.

However, the efforts that Wisconsin makes to minimize the harm for exporters are undone by its throwback rule. Because each state has a different apportionment method, sometimes certain income goes untaxed. Throwback rules, which exist in 22 states and the District of Columbia, throw back this so-called “nowhere income” into the state's taxable base. In many cases, multiple states claim the right to tax the same income, introducing added complexity and double taxation into the tax code.⁷⁸

77 Zachary Petersen, “Wisconsin Corporate Income and Franchise Taxes.”

78 See Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, *2019 State Business Tax Climate Index*, Tax Foundation, Sept. 26, 2018, <https://taxfoundation.org/state-business-tax-climate-index-2019/>.

Corporate Income Tax Reform Solutions

Our corporate income tax reform solutions would make Wisconsin more competitive in the region and nation and more attractive for business investment. These policies eliminate the “sticker shock” associated with Wisconsin’s high statutory income tax rates and prioritize improving the state from a system of taxation that is only competitive for certain industries, positioning the state for future growth.

Conform Treatment of Net Operating Losses

Wisconsin should conform to the new federal rules on NOLs, allowing carryforwards for an unlimited number of years, with the deduction capped at 80 percent of tax liability each year. This linking to the federal code would improve simplicity in the corporate income tax and improve NOL treatment for firms with particularly long time horizons.

Eliminate the Throwback Rule

Wisconsin taxes the “nowhere income” of corporations through its throwback rule, which adds unneeded complexity to the state’s corporate income tax code and creates a potential for double taxation. Wisconsin should eliminate its throwback rule.

Couple to Federal Expensing Rules

Federal tax reform significantly improved the ability of businesses to recover the costs of their investments by allowing 100 percent bonus depreciation for assets with cost recovery periods of 20 years or less. Through 2022, businesses can immediately deduct the full cost of eligible investments, such as the purchase of machinery and equipment, just as they would with any other business expense, rather than the former practice of stretching deductions over many years.

To date, 14 states piggyback off the federal provision, applying the new federal 100 percent bonus depreciation rules to their own corporate tax practices, but Wisconsin is not yet among those states.

Conforming to federal full expensing provisions is one of the most growth-friendly tax policies Wisconsin can adopt, as it would eliminate disincentives for investment and growth that are currently baked into the tax code.

Lower Corporate Tax Rate

Finally, we propose lowering Wisconsin's corporate income tax rate in four options listed in the executive summary. Option A would reduce the rate from 7.9 percent to 7 percent, along with adoption of a low, flat individual income tax and an increased sales tax. Option B would reduce the corporate tax rate to 4.6 percent with across-the-board income tax cuts. Option C would repeal the corporate income tax completely, along with a greatly expanded sales tax base and across-the-board income tax cuts. Option D reduces the corporate income tax to 4 percent, along with a modest reduction to the income tax and increase to the sales tax.

Repeal the Economic Development Surcharge

The Economic Development Surcharge, which is tacked on after corporate tax liability for firms with gross receipts above \$4 million, is a special tax levy with collections dedicated to the Wisconsin Economic Development Corporation (WEDC) instead of the state's general fund. While this tax is capped at \$9,800 to prevent some businesses from having to pay drastically more than others, it is nonneutral in that it only applies to businesses with gross receipts above a certain amount, raising effective corporate rates even higher for those firms. A simpler, more neutral tax structure would avoid instituting narrow new taxes and would instead use broader-based taxes to fund all state priorities.



CHAPTER 5

**STATE AND LOCAL
SALES TAXES**

Introduction

Wisconsin's sales tax is better structured than many other states, but as a source of revenue, it is not being used to its full potential. The extent to which Wisconsin policymakers are willing to improve the sales tax—primarily through base broadening—will determine the quality and quantity of changes the state can make to the more problematic parts of its tax code, such as the corporate income tax and the individual income tax.

Wisconsin's combined state and local sales tax rate is 5.44 percent, the second lowest in the United States (excluding states with no sales taxes), and well below regional peers.

Wisconsin's sales tax is relatively simple. As Wisconsin is a member of the Streamlined Sales and Use Tax Agreement (SSUTA), its sales tax laws comply with basic standards of simplicity and uniformity adopted by almost half the states in the U.S. As a result, Wisconsin is better situated than many other states to collect sales taxes on online transactions from out-of-state retailers, tapping into a valuable and growing stream of revenue.

There is, however, plenty of room for improvement in Wisconsin sales taxation. Thirty states rely more heavily on the sales tax as a source of state and local tax revenue than Wisconsin, a fact that served as the basis for a recommended one point sales tax increase by then-Governor Doyle's Task Force on Educational Excellence in 2004. In fiscal year 2015, the sales tax was responsible for only 19.6 percent of the state's total state and local tax collections. By comparison, Indiana generates 28.7 percent of its state and local tax collections from its sales tax, and in most states the sales tax is comparable to or larger than revenue from property taxes and income taxes. Greater reliance on consumption taxes creates flexibility to rely less heavily on the more economically harmful taxes, such as corporate and personal income taxes.

Wisconsin's sales tax is also hindered by its limited application to services, a fast growing share of the U.S. economy, as well as its exemption of prominent classes of goods. While the state has taken steps to add certain services to its sales tax base, many services remain tax-free, with the state and local governments missing out on potential revenue as a result. The Wisconsin sales tax base applies to a shrinking share of the consumption economy, with resultant effects on sales tax revenue and the services that rely upon it.

In this chapter, we provide a general overview of the Wisconsin sales tax system (both state and local) and offer recommendations for modernization. We explore the Badger State's current sales tax structure, place Wisconsin's sales tax in both a regional and national context, explore options for expanding the base to include additional goods and services, consider the treatment of business inputs, and review the state's adherence to the standards for online sales tax collection established by the U.S. Supreme Court. We conclude the chapter by outlining proposals for reform, including a series of small, medium, and large base expansion options.

History of Wisconsin's Sales and Use Tax

Wisconsin's sales and use tax was adopted in 1961 and took effect in 1962, when it was imposed at a rate of 3 percent on the sale of select goods and services enumerated in law, including motor vehicles, jewelry, household furnishings, alcoholic beverages, tobacco, meals sold in restaurants, hotel rooms, telephone services, admissions, and entertainment.⁷⁹

In 1969, Wisconsin replaced its 3 percent selective sales tax with a 4 percent general sales tax on all tangible personal property except certain goods deemed exempt. The tax remained selective in its application to only those services enumerated in the law. That same year, the state gave counties the option of adopting a 0.5 percent countywide sales tax, but the initial law required revenue be distributed to municipalities.

As a result, no county adopted a sales tax until the law was changed in 1985, allowing counties to keep some of the revenue. In 1986, Barron and Dunn counties became the first to collect local sales taxes.⁸⁰ As of January 1, 2019, 66 of the 72 counties in Wisconsin impose the optional 0.5 percent county sales and use tax.⁸¹ In 1982, the state sales tax rate increased to 5 percent, where it remains to this day.⁸²

Sales Tax Rate Composition

Wisconsin is similar to most of its regional competitors in that it has a two-part sales tax: a state-level rate that is levied throughout the entire state, and local option sales taxes that are levied in specific jurisdictions or tax districts. Wisconsin's sales tax currently consists of a 5 percent general state sales tax, an optional 0.5 percent state-collected county sales tax with revenues remitted to counties that have adopted the tax, and a 0.1 percent sales tax levied in the Southeast Wisconsin Professional Baseball Park District, which is comprised of Milwaukee, Ozaukee, Racine, Washington, and Waukesha counties. Accordingly, the total state and local sales tax rate in any given county is either 5.0 percent, 5.1 percent, 5.5 percent, or 5.6 percent.

As of July 1, 2018, when each county's local rate was weighted according to population, the average local rate was 0.44 percent, for an average statewide combined state and local sales tax rate of 5.44 percent, one of the lowest combined sales tax rates in the country (Figure 5a). Among states that levy state or local sales taxes, only three states have combined rates lower than Wisconsin's: Wyoming (5.39 percent), Hawaii (4.35 percent), and Alaska (1.76 percent). It is important to note that major anomalies in Hawaii and Alaska's sales taxes contribute to their low rates.⁸³ As such, Wisconsin's combined

79 Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017, 57, <https://www.revenue.wi.gov/DORReports/17sumrpt.pdf>.

80 "Nickels and Dimes: The Wisconsin Sales Tax," *The Wisconsin Taxpayer* 74, no. 2 (February 2006), 5, <https://wistax.org/publication/download/nickels-and-dimes-the-wisconsin-sales-tax>.

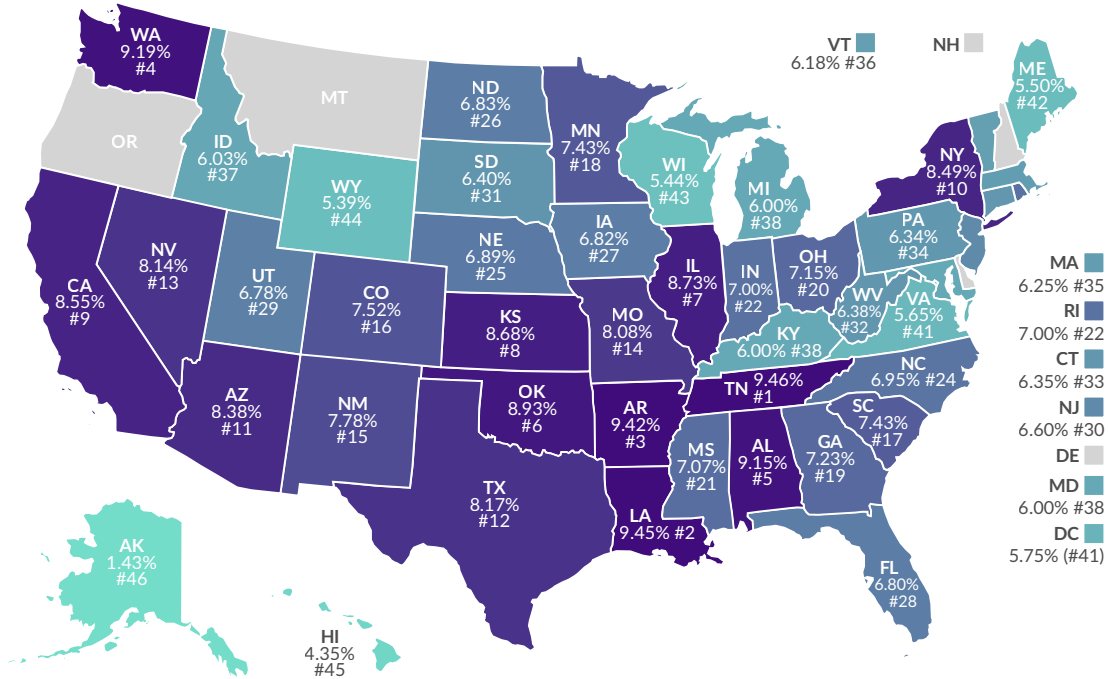
81 "Sales Tax Clearinghouse data; Tax Foundation calculations.

82 *Ibid.*, 57.

83 Hawaii's sales tax base is so broad that it is larger than the size of the state's economy due to multiple layers of taxation applied to the same product or service. This "tax pyramiding" is considered by most experts to be economically damaging. As a result, even with its low rate, Hawaii has the highest sales tax collections per capita. Alaska has the lowest combined rate because the state allows local sales taxes but does not have a state-level sales tax.

sales tax rate is the second lowest among states that levy both state and local sales taxes and have a base similar to Wisconsin's.

FIGURE 5a.
Sales Tax Rates by State
 Combined State & Average Local Sales Tax Rates, July 1 2018



Note: City, county, and municipal rates vary. These rates are weighted by population to compute an average local tax rate. Three states levy mandatory, statewide, local add-on sales taxes at the state level: California (1.25%), Utah (1.25%), and Virginia (1%); we include these in their state sales tax. The sales taxes in Hawaii, New Mexico, North Dakota, and South Dakota have broad bases that include many services. This map does not include sales taxes in local resort areas in Montana. Salem County is not subject to the statewide sales tax rate and collects a local rate of 3.3125%. New Jersey's average local score is represented as a negative.

Source: Sales Tax Clearinghouse, Tax Foundation calculations, State Revenue Department websites.



Not only is Wisconsin's 5.44 percent combined state and average local sales tax rate one of the lowest in the country, but its 5 percent state sales tax rate alone is also relatively low. Thirty-two states have higher state sales tax rates than Wisconsin, and Wisconsin's rate is significantly lower than the rates in neighboring states. Table 5a shows the state, average local, and combined sales tax rates in Wisconsin and bordering states. Among its neighbors, Wisconsin is the only state with a sales tax rate below 6 percent.

TABLE 5a.

Average Combined State and Local Sales Tax Rates

Wisconsin and Nearby States (July 2018)

State	State Rate	Avg. Local Rate	Total Rate	National Rank
Illinois	6.25%	2.48%	8.73%	7
Indiana	7.00%	--	7.00%	22
Iowa	6.00%	0.82%	6.82%	27
Michigan	6.00%	--	6.00%	38
Minnesota	6.875%	0.55%	7.43%	18
Wisconsin	5.00%	0.44%	5.44%	43

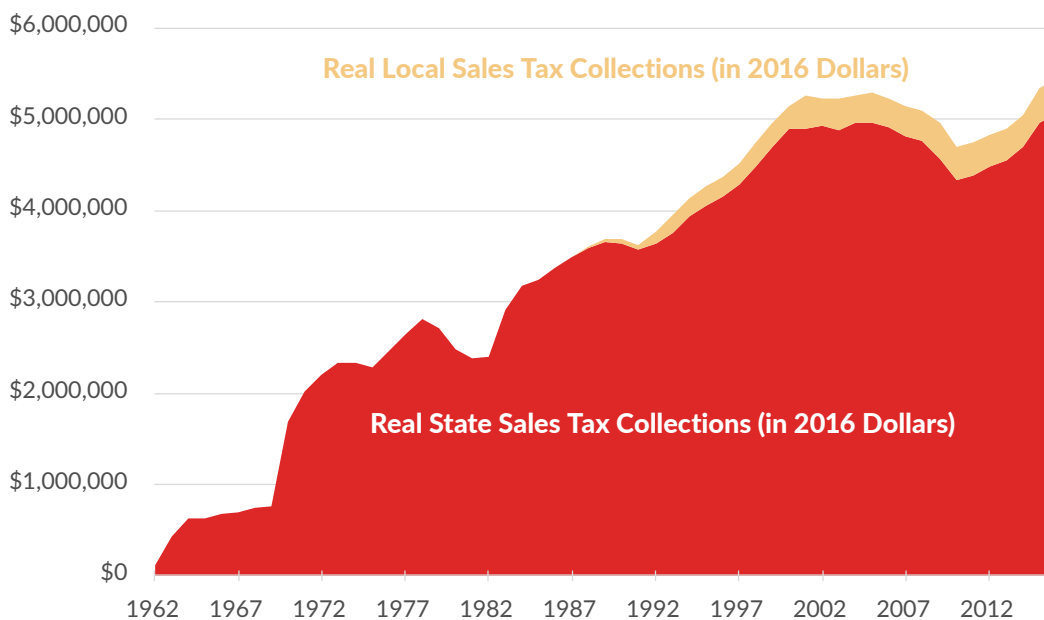
Source: Tax Foundation, "State and Local Sales Tax Rates 2018, Midyear 2018."

Sales Tax Collections

The sales tax is one of the primary sources of state tax revenue in Wisconsin. In fiscal year 2016, the sales tax generated 28.7 percent of Wisconsin's total state tax collections, lower than the individual income tax, which generated 42.5 percent of total collections, but more than any other single source of state tax revenue. Nationwide, the average state's sales tax comprises approximately 31.5 percent of state tax collections.⁸⁴

Since Wisconsin's sales tax was first collected in 1962, sales tax collections have grown significantly over time, even after adjusting for inflation (Figure 5b). Between 1990 and 2016, combined state and local sales tax collection grew by 48 percent in real dollars.

FIGURE 5b.

**Wisconsin State and Local Sales Tax Collections, 1962–2016
(in Thousands of 2016 Dollars)**

Source: U.S. Census Bureau, State Government Tax Collections.

84 U.S. Census Bureau, "2015 State & Local Government Finance Historical Datasets and Tables," <https://www.census.gov/data/datasets/2015/econ/local/public-use-datasets.html>.

Sales Tax Base Composition

Like most states, Wisconsin imposes its sales tax on a base that consists primarily of goods—with economically significant policy carveouts—and relatively few services. Wisconsin’s general sales tax applies to the purchase of tangible personal property, or goods, unless specifically exempted under the law. By contrast, the sales tax does not apply to the purchase of services except those specifically enumerated in law. Although Wisconsin’s sales tax base is somewhat broader than the average state’s, it falls short of what most public finance scholars would define as optimal.

Taxation of Goods

Goods that have been explicitly exempted from Wisconsin’s sales and use tax include grocery foods, prescription drugs, bottled water, gasoline, residential energy, and newspapers, among others. In fiscal year 2016, sales tax exemptions for food, bottled water, and motor fuels alone amounted to nearly \$1.02 billion in forgone revenue.⁸⁵

Many of these goods have been exempted from the sales tax base for political reasons. While most states face political pressure to exempt certain goods from their sales tax base, eliminating these exemptions would allow states to significantly lower sales tax rates or the rates of more economically damaging taxes while generating the same amount of revenue, and in a more stable fashion.

TABLE 5b.
Wisconsin’s Tax Exemptions for Consumer Goods with Value of \$1 Million and Above, Fiscal Year 2016

Exemption	Amount
Food and Food Ingredients (not including bottled water)	\$601,900,000
Motor Fuels	\$390,100,000
Prescription Drugs and Medicines (excluding insulin)	\$172,600,000
Fuel and Electricity for Residential Use	\$144,600,000
Water Sold through Mains	\$25,100,000
Bottled Water	\$23,300,000
Medical Devices (including wheelchairs, home oxygen equipment)	\$20,100,000
Newspapers, Periodicals, and Shoppers Guides	\$13,300,000
Insulin and Equipment Used in the Treatment and Testing of Diabetes	\$8,300,000
Meals Furnished by Institutions of Higher Education	\$7,700,000
Caskets and Burial Vaults	\$5,100,000
Self-Service Laundry and Self-Service Dry-Cleaning Services	\$1,900,000

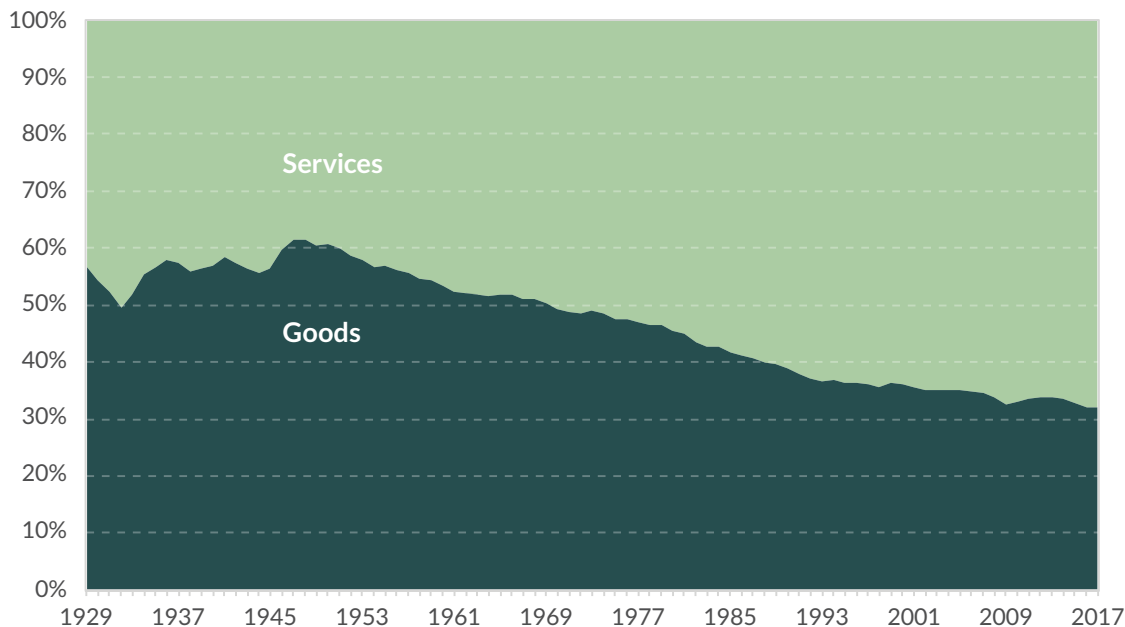
Source: Wisconsin Department of Revenue and Department of Administration, “Summary of Tax Exemption Devices,” 2017.

Taxation of Services

Most states, including Wisconsin, by default exclude most services from their sales tax base. This exclusion is a historical accident, as services represented a much smaller share of economic activity in the 1930s when state sales taxes were first enacted. Prior to the sales tax, the property tax served as the primary revenue generator for state and local governments. However, the decline in property values during the Great Depression brought with it a decline in property tax collections, and individual and corporate income taxes also became less productive from a revenue-generating standpoint.⁸⁶ These revenue constraints, coupled with increased spending mandates from the federal government, caused states to turn to the sales tax as a supplemental source of revenue. At the time, manufacturing was the primary driver of economic activity, so taxes that applied only to the sale or use of tangible goods were sufficient for generating revenue. Over time, however, the U.S. economy shifted from manufacturing-based to service-based, and Americans are now purchasing more services than goods as a percentage of total consumption (Figure 5c).

FIGURE 5c.

Percentage of Total Personal Consumption Expenditures Goods vs. Services, U.S., 1929-2017



Source: Bureau of Economic Analysis, Regional Economic Accounts.

When Wisconsin first enacted its sales tax, it applied only to tangible personal property and did not include many services. Over time, however, certain services were added to Wisconsin's sales tax base, including cable television and installation services (1975), interstate telephone and telegraph services (1982), landscaping services (1982), coin-operated telephone services (1996), and personal telephone services (1996). Other taxable services include admissions to athletic, amusement, entertainment, and recreational events; laundry and dry-cleaning services; hotel lodging; internet access;

86 Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax," Tax Foundation, Oct. 24, 2017, <https://taxfoundation.org/sales-tax-base-broadening/>.

photography; parking and storage; repair, inspection, and maintenance services; and motor vehicle towing services.⁸⁷

While Wisconsin has taken steps to modernize its sales tax over time, many prominent categories of services remain excluded, such as legal services, computer services, healthcare services, and personal care services (haircuts, pedicures, etc.). In 2016, the state missed out on an estimated \$1.1 billion in revenue due to its exclusion of certain services from the sales tax base (Table 5c).

TABLE 5c.

Wisconsin's Tax Exemptions for Consumer Services with Value of \$1 Million and Above, Fiscal Year 2016

Exemption	Amount
Services of Physicians, Dentists, and Other Health Professionals	\$606,600,000
Legal Services	\$118,400,000
Architectural, Engineering, Testing Laboratory, and Surveying Services	\$104,800,000
Accounting Services	\$60,800,000
Commissions to Real Estate Brokers	\$50,000,000
Sewerage Services	\$36,200,000
Beauty, Barber, Nail, and Other Personal Care Services	\$33,300,000
Veterinary Services for Pets	\$26,300,000
Health Clubs	\$22,000,000
Funeral Services, excluding Caskets and Vaults	\$14,300,000
Dues and Fees Paid to Business Associations and Fraternal Organizations	\$13,900,000
Bank Account Service Charges	\$8,200,000
Admissions to Educational Events and Places	\$6,100,000
Tax Preparation Services	\$5,400,000
Disinfecting and Exterminating	\$4,900,000
Auto and Travel Clubs	\$3,700,000
Interior Design	\$3,400,000

Note: Estimates for some services such as legal services include some business-to-business transactions in addition to consumer transactions.

Source: Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," 2017.

Sales Tax Breadth

Ideally, the sales tax should apply to all final personal consumption. This allows the base to be as broad as possible without taxing business-to-business transactions. This approach results in the lowest possible rate, while creating neutrality in the tax, by not favoring one class of items to another.

The trend toward service consumption over goods consumption, paired with political pressure to exempt goods from the sales tax base, however, has contributed to the erosion of state sales tax bases, meaning state sales tax bases, including in Wisconsin, fall far from this ideal standard.

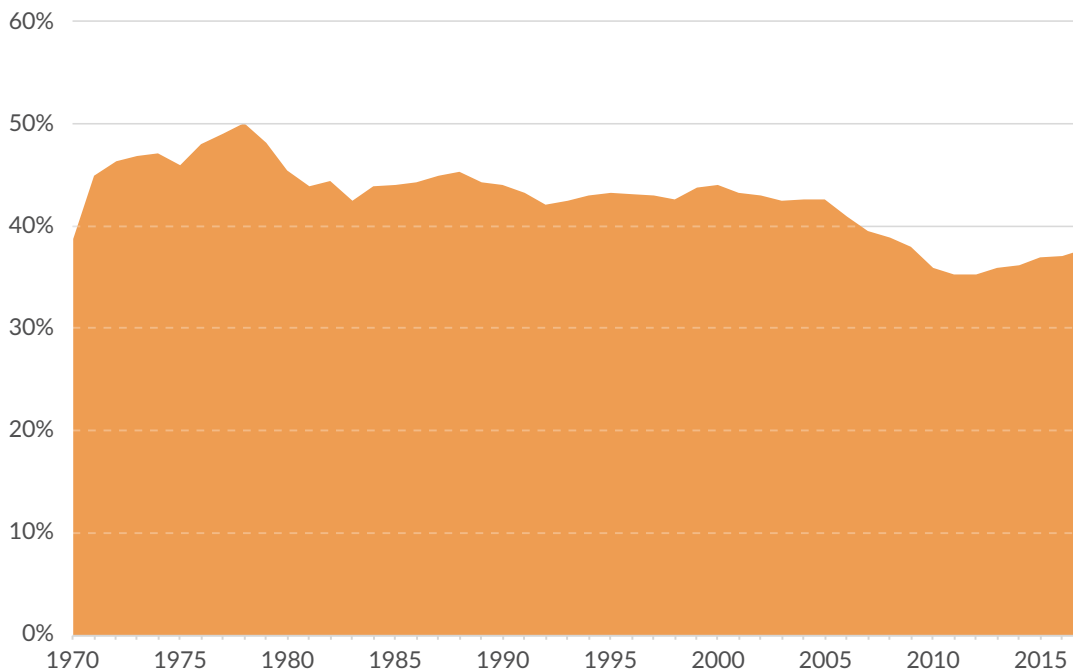
To combat base erosion, Wisconsin should reconsider its exemption of certain goods from the sales tax base, such as groceries, bottled water, newspapers, and others. Further, the state should broaden its sales tax base by applying the sales tax to additional services as the economy becomes increasingly service-oriented.

Because sales tax bases vary widely from state to state, it can be difficult to objectively compare one state's sales tax base to another's. One useful method, however, is to calculate the value of taxed transactions as a percentage of total personal income in the state. Wisconsin's sales tax breadth as a percentage of state income is 37 percent, putting it in the middle of the pack compared to other states,⁸⁸ meaning the state's sales tax base is broader than some, but narrower than others. A robust sales tax base would not reach 100 percent without double taxation—as not all income is consumed in any given year—but could tax as much as 75 percent of state income. Goods and services combined, Wisconsin has a sales tax base that is broader than Illinois and comparable to Iowa and Minnesota but narrower than Michigan.

Though Wisconsin's sales tax is relatively young (dating to 1963, while most state sales taxes date to the 1930s), there is still an observable erosion in the base since the 1970s (Figure 5d).

FIGURE 5d.

Wisconsin Sales Tax Breadth, 1970-2017



Source: Prof. John Mikesell, Indiana University

88 Nicole Kaeding, "Sales Tax Base Broadening: Right-Sizing a State Sales Tax" (citing work by Professor John Mikesell of Indiana University).

Taxation of Business Inputs

When contemplating broadening the sales tax base, it is important to maintain proper treatment of business inputs. A well-structured sales tax is imposed on all final consumer goods and services while exempting all purchases made by businesses that will be used as inputs in the production process. This is not because businesses deserve special treatment under the tax code, but because applying the sales tax to business inputs results in multiple layers of taxation embedded in the price of goods once they reach final consumers, a process known as “tax pyramiding.” The result is higher and inequitable effective tax rates for different industries and products, which is both nonneutral and nontransparent.

Ideally, business inputs would be exempted based upon the identity of the purchaser. In practice, however, states must generally make binary choices which are not always entirely clear-cut, as there are many goods and services which are consumed by businesses and individuals alike. For instance, when a business retains an outside accounting firm, that is clearly a business input, but individuals sometimes hire accountants as well.

Sometimes this problem can be resolved, albeit imperfectly, by considering typical use. While a select few individuals might occasionally rent a cold storage facility or take out advertising, these services are overwhelmingly purchased by businesses, and the rare exception should not guide policy. A more interesting case arises with goods that are consumed by both businesses and individuals but which, when used by businesses, are not a direct part of the production process.

Businesses and individuals both buy desk chairs and both procure landscaping services. In such cases, exemption certificates are optimal, as they can address the use case of the company ordering a thousand desk chairs.

Nonprofits and agricultural purchasers are often granted exemption certificates that exempt transactions from sales taxes based on the purchaser’s identity rather than a determination of whether the good or service is most likely to be purchased by a business or a consumer. The chief shortcoming of exemption certificates is the administrative hassle they create for the state, the seller, and the purchaser alike. A policy of exempting transactions that are overwhelmingly or exclusively business inputs, while allowing exemption certificates to be used to avoid tax on mixed-use goods and services when the purchaser is a business, represents the best available policy option.

While most states make some effort to exclude business inputs from taxation, few do so consistently or uniformly. Wisconsin has taken steps to address the taxation of business inputs, exempting farm equipment, manufacturing machinery and raw materials, and business fuel and utilities from the sales tax. Nevertheless, other inputs continue to be subject to the tax, undermining tax neutrality and allowing tax costs to be embedded in the final price of goods several times over.

Wisconsin's Sales Tax Holiday is a Base-Narrower

In 2018, Wisconsin was one of 17 states to hold a “sales tax holiday,” where certain items are temporarily exempt from the sales tax. Some states have written sales tax holidays into their tax code to occur on a repeated basis, but Wisconsin’s sales tax holiday was a one-time occurrence that will not be repeated unless enacted by future legislation, and ideally, Wisconsin will not continue the holiday.

The 2018 sales tax holiday was the first sales tax holiday in Wisconsin’s history, designed to provide sales tax relief on “back-to-school” items purchased between August 1st and 5th, 2018. Eligible goods included clothing priced at no more than \$75, computers and computer supplies priced at no more than \$750 and \$250, respectively, and purchased for personal (not business) use, and school supplies priced at \$75 or less per item. The state Department of Revenue estimated the holiday resulted in \$14.8 million in forgone revenue.⁸⁹

The literature on sales tax holidays tends to show that they do not have a stimulative economic effect, and instead merely shift the timing of purchases that would have occurred anyway into the holiday period. Reports from retailers show a significant complexity to complying with the holiday as well, as the state essentially enacts a second, different sales tax code for just a few days out of the year.⁹⁰

Taxation of E-Commerce

The rise of e-commerce also plays a role in the erosion of state sales tax bases. Prior to the U.S. Supreme Court’s ruling in *South Dakota v. Wayfair*,⁹¹ retailers were obligated to collect and remit sales taxes only in states in which they had a physical presence, defined as having property or employees within the state. The geographic limitation on the scope of state sales tax authority, as defined in *Quill v. North Dakota*,⁹² became increasingly concerning to states as online transactions drove remote sales upward.

The *Quill* decision was handed down in 1992, near the low ebb of remote sales, when the mail-order businesses of the twentieth century, such as Sears Roebuck, Montgomery Ward, and Bella Hess (itself the subject of a prior Supreme Court ruling on the taxation of remote sales) were either gone or on their last legs. Today, however, interstate sales are much more common, and online sales account for a substantial share of consumption expenditures. Americans spent about \$453.5 billion in internet retail purchases in 2017, representing a 16 percent increase over the previous year and comprising about 8.9 percent of total retail sales.⁹³ This growth rate has been fairly steady, and it is likely that e-commerce will continue to grow as a share of national retail sales, making reliable

89 Glen Moberg, “Walker Touts Back-To-School Sales Tax Holiday Starting Wednesday,” Wisconsin Public Radio, July 31, 2018, <https://www.wpr.org/walker-touts-back-school-sales-tax-holiday-starting-wednesday>.

90 Scott Drenkard and Joseph Bishop-Henchman, “Sales Tax Holidays: Politically Expedient but Poor Tax Policy, 2018,” Tax Foundation, July 17, 2018, <https://taxfoundation.org/sales-tax-holidays-politically-expedient-poor-tax-policy-2018/>.

91 *South Dakota v. Wayfair, Inc.*, 585 U.S. ___, slip op. (2018).

92 *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

93 U.S. Department of Commerce, “Quarterly Retail E-Commerce Sales 1st Quarter 2018,” U.S. Census Bureau News, May 17, 2018, <https://www2.census.gov/retail/releases/historical/ecomm/18q1.pdf>. This percentage continues to rise, and hit 9.5 percent of total sales in the first quarter of 2018, compared to 8.5 percent in the first quarter of 2017.

collection of sales and use taxes all the more important.

South Dakota v. Wayfair

On June 21, 2018, the U.S. Supreme Court handed down a landmark decision in *South Dakota v. Wayfair*, overturning the *Quill* physical presence standard and allowing states to require out-of-state retailers to collect and remit state and local sales taxes. Importantly, the *Wayfair* decision did not offer states a blank check to require all retailers everywhere to collect their sales tax. In fact, the *Wayfair* majority opinion outlined several features of South Dakota's remote sales tax law that "appear designed to prevent discrimination against or undue burdens upon interstate commerce,"⁹⁴ sending a strong signal to states regarding the types of baseline standards they should implement into their sales tax laws to avoid being struck down as unconstitutional.

Those features, sometimes referred to as the *Wayfair* "checklist,"⁹⁵ are as follows:

1. **Safe harbor:** Exclude "those who transact only limited business" in the state. (South Dakota's law only requires retailers to collect the sales tax if they make \$100,000 worth of sales or engage in 200 transactions in a given state.)
2. **No retroactive collection.**
3. **Single state-level administration** of all sales taxes in the state.
4. **Uniform definitions** of products and services.
5. **Simplified tax rate structure.** (South Dakota requires the same tax base between state and local sales taxes, has only three sales tax rates, and has limited exemptions from the tax.)
6. **Software:** Access to sales tax administration software is provided by the state.
7. **Immunity:** Sellers who use the software are not liable for errors derived from relying on it.

The *Wayfair* decision leaves states with important policy decisions to make, such as setting safe harbor thresholds and enforcement dates, simplifying the process by which they collect state and local sales taxes, making their sales tax bases less complex, and deciding how to use the revenue.

94 *Wayfair*, 585 U.S. ___ at 23.

95 See Joseph Bishop-Henchman, "Testimony: Post-Wayfair Options for Congress," Tax Foundation, July 24, 2018, <https://taxfoundation.org/post-wayfair-options-congress/>; and Georgia State University, Center for State and Local Finance, "Supreme Court Wayfair Decision Offers Blueprint for States," July 16, 2018, <https://cslf.gsu.edu/2018/07/16/supreme-court-wayfair-dakota-nexus/>.

Wisconsin is Poised to Benefit from the *Wayfair* Decision

Wisconsin satisfies the key components of the *Wayfair* “checklist” and, as of October 1, 2018, had begun requiring remote sellers to collect its state and local sales taxes. Like South Dakota, Wisconsin has adopted the Streamlined Sales and Use Tax Agreement and is a member of the Streamlined Sales Tax Project (SSTP), thereby requiring sellers to file with only the state—not local governments—when registering to collect Wisconsin’s state and local sales taxes.

Similarly, in Wisconsin, definitions of products and services are consistent at the state and local levels, meaning if a product or service is taxable at the state level, it is also taxable at the local level for those localities which choose to levy a local sales tax. In addition, Wisconsin’s general sales tax has a limited number of rates—just one state rate (5 percent), one optional local rate (0.5 percent), and the 0.1 percent Southeast Wisconsin Professional Baseball Park District rate. On any given transaction, Wisconsin’s sales tax either applies or it does not; Wisconsin law does not allow the state or local governments to apply different sales tax rates to different types of goods and services. Illinois, however, does apply different sales tax rates to different goods: while the general sales tax rate is 6.25 percent, groceries are taxed at a 1.00 percent sales tax rate.⁹⁶ The *Wayfair* decision discourages this application of differential rates to different components of a state’s sales tax base, and Wisconsin is at an advantage compared to states with several different sales tax rates. Finally, Wisconsin has a central electronic registration system run through the SSTP, which is available to remote sellers who register to collect the state’s sales tax.

With respect to the safe harbor component (how much business an out-of-state vendor must conduct before being subject to Wisconsin sales taxes), in December 2018, 2017 Wisconsin Act 368 was enacted, establishing for Wisconsin a safe harbor from sales tax collection requirements for retailers with less than \$100,000 in sales or fewer than 200 transactions in Wisconsin, consistent with South Dakota’s law.⁹⁷ Finally, the DOR has not sought to enforce its new rules retroactively.⁹⁸

According to the DOR’s initial projections, expanded remote sales tax collection is expected to generate \$90 million in additional sales and use tax revenue for Wisconsin in 2018-2019, followed by \$120 million in fiscal year 2019-2020. In addition, expanded remote collection of local sales taxes and the Southeast Wisconsin Professional Baseball Park District sales tax is expected to generate a total of \$7.7 million in local revenue in 2018-2019 and \$10.3 million in 2019-2020.⁹⁹

96 Morgan Scarboro, “Facts and Figures 2018: How Does Your State Compare?” Tax Foundation, March 21, 2018, Table 32, <https://taxfoundation.org/facts-figures-2018/>.

97 Wisconsin Legislature: 137.01. Accessed January 22, 2019, <https://docs.legis.wisconsin.gov/2017/related/acts/368>.

98 Wisconsin State Legislature, “Emr1819 Rule Text,” accessed Sept. 21, 2018, https://docs.legis.wisconsin.gov/code/register/2018/753A2/register/emr/emr1819_rule_text/emr1819_rule_text.

99 Wisconsin Legislative Fiscal Bureau, “*South Dakota v. Wayfair, Inc.*—Sales and Use Tax Collections on Remote Sales,” July 2, 2018, http://docs.legis.wisconsin.gov/misc/lfb/misc/165_south_dakota_v_wayfair_inc_sales_and_use_tax_collections_on_remote_sales_7_2_18.pdf.

However, those estimates were revised downward in November of 2018. The Wisconsin Legislative Fiscal Bureau wrote that the \$120 million revenue was now only estimated at \$60 million annually, due to “lower observed compliance than originally expected.”¹⁰⁰

In December of 2018, policymakers in Wisconsin decided how to allocate this additional revenue. According to Act 368, any revenue collected from October 1, 2018 to September 30, 2019 from “out-of-state retailers” will be dedicated to reducing individual income tax rates for the “tax year ending on December 31, 2019.”¹⁰¹ If the state collects \$60 million in new revenues, the DOR estimates that individual income tax rates, in every bracket, will decrease by approximately 0.04 percent.¹⁰²

Sales Tax Reform Solutions

Wisconsin’s sales tax begins with a broader base than is found in many states, but it remains too narrow to grow with today’s service-oriented economy. Carveouts for select goods further reduce revenue stability and require higher rates than might otherwise be necessary. Since Wisconsin’s sales tax has a relatively simple structure and a competitive rate, our recommendations focus on broadening the sales tax base to include additional goods and services, which can help generate the revenue to “pay for” structural changes and rate reductions elsewhere in the tax code; namely, to the corporate income tax and the individual income tax.

Base-Broadening Options

A well-structured sales tax applies to all final consumer purchases, both goods and services, while exempting business inputs. Currently, the Wisconsin sales tax specifically exempts a significant number of consumer transactions which, if included in the base, would permit rate reductions elsewhere in the tax code.

Lawmakers should consider expanding the sales tax base with additional goods and services while exempting business inputs. Table 5d shows three options for base broadening, where the “small” option adds a few additional consumer goods and services to the sales tax base, and the “large” option is the broadest, adding nearly all consumer goods and services that currently enjoy an exemption.

100 Wisconsin Legislative Fiscal Bureau, “December 2018 Extraordinary Session Bills,” Nov. 30, 2018, http://docs.legis.wisconsin.gov/misc/lfb/bill_summaries/2017_19/0001_december_extraordinary_session_bills_11_30_18.pdf.

101 2017 Wisconsin Act 368, Section 13.

102 Wisconsin Department of Administration, Division of Executive Budget and Finance, “Fiscal Estimate-2017 Session, LRB Number 17-6075/1,” https://docs.legis.wisconsin.gov/2017/related/fe/sb883/sb883_DOR.pdf.

TABLE 5d.
Sales Tax Base-Broadening Options

	Small Base Broadening	Moderate Base Broadening	Large Base Broadening
Beauty, Barber, Nail, and Other Personal Care Services	✓	✓	✓
Newspapers, Periodicals, and Shoppers Guides	✓	✓	✓
Veterinary Services for Pets	✓	✓	✓
Health Clubs	✓	✓	✓
Auto and Travel Clubs	✓	✓	✓
Interior Design	✓	✓	✓
Tax Preparation Services	✓	✓	✓
Disinfecting and Exterminating	✓	✓	✓
Admissions to Educational Events and Places	✓	✓	✓
Self-Service Laundry and Dry-Cleaning Services	✓	✓	✓
Meals Furnished by Institutions of Higher Education	✓	✓	✓
Bank Account Service Charges	✓	✓	✓
Fuel and Electricity for Residential Use	✓	✓	✓
Caskets and Burial Vaults	✓	✓	✓
Accounting Services	✓	✓	✓
Sewerage Services	✓	✓	✓
Food and Food Ingredients (not including bottled water)	✓	✓	✓
Bottled Water	✓	✓	✓
Funeral Services, excluding Caskets and Vaults	✓	✓	✓
Dues and Fees Paid to Business Associations and Fraternal Organizations	✓	✓	✓
Motor Fuels		✓	✓
Legal Services		✓	✓
Prescription Drugs and Medicines (excluding insulin)			✓
Insulin and Equipment Used in the Treatment and Testing of Diabetes			✓
Medical Devices (including Wheelchairs, Home Oxygen Equipment)			✓

Sales Tax Rates

In many ways, the robustness of the reforms to corporate and individual income tax structures in Wisconsin is dependent on what legislators plan to do for sales tax reform. All four of our comprehensive tax reform options rely on sales tax base broadening, though the extent of this base broadening varies. Option A employs moderate base broadening while raising the sales tax rate to 5.75 percent. Options B and D employ moderate base broadening while keeping the sales tax rate at 5 percent. Option C includes large base broadening and a slightly higher sales tax rate of 5.2 percent.

Potential Windfall to Local Governments from Sales Tax Base Expansion

Because Wisconsin's state and local sales tax bases are uniform, expansion of the sales tax base at the state level would result in a broader base for county governments as well, increasing revenue for these governments. The state could permit the windfall to counties to occur, revisit the level of local option sales tax rates in proportion to the broader base, or limit base expansion for local option sales taxes. Any windfall would likely be uneven across the state, depending on what goods and services the sales tax base covers and the prevalence of those activities in particular counties.

Impact of Sales Tax Solutions on Real People

The chart below shows how individual taxpayers would be impacted by the sales tax provisions in our comprehensive tax reform solutions. Because each of our comprehensive tax reform solutions is approximately revenue-neutral, most taxpayers would pay less in income taxes while paying more in sales taxes under Options A, B, C, and D.

How Wisconsin Tax Reform Options Affect Real People (State Sales Tax Liability)

	Current Wisconsin Tax System	Option A	Option B	Option C	Option D
 Abigail One child Income: \$15,000 Filing Status: Head of Household	\$525	\$801	\$697	\$744	\$697
 Patrick & Samantha Retired no children Income: \$36,000 Filing Status: Married Filing Jointly	\$600	\$915	\$797	\$850	\$797
 Daniel Single no children Income: \$50,000 Filing Status: Single	\$800	\$1,220	\$1,062	\$1,134	\$1,062
 Jason & Nicole Two children Income: \$75,000 Filing Status: Married Filing Jointly	\$1,088	\$1,659	\$1,444	\$1,542	\$1,444
 Monique Single no children Income: \$100,000 Filing Status: Single	\$1,300	\$1,983	\$1,726	\$1,842	\$1,726
 Peter & Kelsey Two children Income: \$150,000 Filing Status: Married Filing Jointly	\$1,875	\$2,860	\$2,489	\$2,657	\$2,489

Source: Tax Foundation calculations using data from Bureau of Labor Statistics's Consumer Expenditure Survey and Wisconsin Department of Revenue. Excludes local sales taxes, excise taxes, federal tax liability, and other local taxes. Sales tax base calculation assumptions used average estimates from national Consumer Expenditure Survey data. Assumes households at \$15,000 spend 70 percent of income on taxable purchase at the current sales tax base; at \$36,000, 33 percent; at \$50,000, 32 percent; at \$75,000, 29 percent; at \$100,000, 26 percent; at \$150,000, 25 percent. Calculations resulted in a medium tax base (Options A, B, and D) that is 32.7 percent larger than the current base and a large sales tax base (Option C) that is 41.7 percent larger than the current base.

It is important to keep in mind that part of the purpose of sales tax base broadening is to make sales tax collections more stable than they are under current law, making future tax rate increases less likely. However, should lawmakers wish to make structural improvements to the tax code, including sales tax base broadening, while simultaneously offering more taxpayers an overall tax cut, other options could be considered, such as deeper income tax rate reductions or a combination of income and sales tax rate reductions.

For example, the inclusion of groceries in Wisconsin’s sales tax base would result in taxpayers of every income level paying more in sales taxes than they do under current law. To mitigate the impact of sales tax increases on lower-income residents, these base-broadening reforms could be accompanied by reforms to the existing Earned Income Tax Credit (EITC), a refundable tax credit for low- and moderate-income working individuals and families, to make the credit more generous.

Another option would be to offer a new and separate credit to offset the impact of sales tax base broadening provisions on low- and middle-income taxpayers. Idaho is an example of a state that applies its sales tax to groceries but offers a refundable “grocery credit” to offset sales taxes paid on groceries throughout the year.¹⁰³

103 Idaho State Tax Commission, “Idaho Grocery Credit,” Accessed February 3, 2019, <https://tax.idaho.gov/i-1043.cfm>.



CHAPTER 6

PROPERTY TAXES

Introduction

Wisconsin's property tax has been an object of perennial ire throughout the state's history. In most instances, the property tax was at least indirectly involved in major Wisconsin tax reform efforts, including the 1911 creation of the state's income tax, which was ostensibly put forward with the goal of reducing property tax burdens.

Though the property tax has grown in the last five decades, recent tax limitation reforms have put property taxes on a downward trajectory and should be allowed to continue to work. Statewide efforts at property tax reduction through an assortment of programs, such as shared revenue and special tax credits, have weakened the link between locally-provided services and their costs to citizens, meaning local services are now being financed at the state level. As a result, the state tax rates are now higher than they would otherwise be to finance the numerous revenue transfers to the local governments.

Wisconsin should continue to prioritize the full repeal of tangible personal property taxes, which are a relic of a bygone era.

However, there are some bright spots in Wisconsin's property tax system. The state generally forgoes distortive property taxes like intangible taxes, inventory taxes, and estate and inheritance taxes.

A General Overview of Wisconsin's Property Taxes

Property taxes are among the oldest forms of taxation and remain the most significant source of local government revenue in many states, Wisconsin included.

Once a significant state as well as local revenue tool, the property tax's current form is the product of many decades of evolution. Today, the property tax, primarily levied on land and improvements, serves as the single largest source of revenue for Wisconsin's local governments, accounting for 35 percent of all local revenues in 2016.¹⁰⁴

Property taxes tend to be justified economically as a generally efficient form of taxation that raises revenue with a minimal effect on economic decision-making. Practically, they also enjoy a history as a well-established source of funding that is both familiar and not easily replaced.

104 U.S. Census Bureau, "2016 State & Local Government Finance Historical Datasets and Tables," <https://www.census.gov/data/datasets/2016/econ/local/public-use-datasets.html>.

Because real property is an immobile asset, tax competition and tax avoidance are less prevalent than they would be from other available tax options.¹⁰⁵ Further, while income taxes are known to discourage labor and investment, property taxes by contrast tend to be more economically neutral.¹⁰⁶

Property taxes also come closer than most taxes to conforming to the benefit principle, an ideal in the public finance field that taxes paid should correlate with government benefits received. However imperfect, the value of one's property is a better proxy for the value of local services received than most alternative tax bases. For example, roads, utilities, police and fire protection, and local public amenities all increase or preserve the value of property, and, if supplied privately, would likely increase in worth with higher property values.¹⁰⁷

Wisconsin's property tax system is even more neutral than other states due to a strong uniformity clause in the state constitution. As a result, taxes do not vary by type or use (with the exception of agricultural land), unlike in some other states, where different classes of property are assessed or taxed at different rates or assessment ratios (called split roll).¹⁰⁸

Property Tax Collections

Wisconsin's property tax collections are on the high side nationally but have declined in recent years. In fiscal year 2015, state and local property taxes were \$1,616 per capita, 14th highest nationally (Figure 6a). This number is higher than some nearby states but is a far cry from Illinois' collections of \$2,087 per capita. It is further likely that Wisconsin will rank better on this metric once U.S. Census Bureau data catches up to the 2017 elimination of Wisconsin's statewide property tax levy.

Figure 6b shows property tax collections since 1960. Collections grew steadily from the 1980s until the Great Recession. Since 2009, however, property tax collections have fallen in real terms as tight property tax caps have started to control growth of the levy.

Property taxes are not just paid by individuals. Businesses, throughout the Badger State, pay property taxes on their land, their structures, and their tangible personal property (discussed later in this chapter). In fiscal year 2016, Wisconsin businesses paid an estimated \$5 billion in property taxes to state and local governments.¹⁰⁹

105 For a discussion of strategic competition in property tax regimes, see Jan K. Brueckner and Luz A. Saavedra, "Do Local Governments Engage in Strategic Property-Tax Competition?" *National Tax Journal* 54 no. 2 (June 2001), <https://www.ntanet.org/NTJ/54/2/ntj-v54n02p203-30-local-governments-engage-strategic.pdf?v=%CE%B1&r=03589733876287937>.

106 Bruce Wallin and Jeffrey Zabel, "Property Tax Limitations and Local Fiscal Conditions: The Impact of Proposition 2½ in Massachusetts," Lincoln Institute of Land Policy Working Paper, 2010, 4, http://www.lincolinst.edu/sites/default/files/pubfiles/1885_1200_wallin_zabel_wp11bw1.pdf.

107 Ibid., 4-5.

108 Andrew Reschovsky, "Wisconsin: Significant Features of the Property Tax," Lincoln Institute of Land Policy, updated February 2018, http://datatoolkits.lincolinst.edu/subcenters/significant-features-property-tax/upload/files/tax_digest/WI_Feb_2018.pdf.

109 Andrew Phillips, Caroline Sallee, and Charlotte Peak, "Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2016," State Tax Research Institute, Council on State Taxation, and EY, August 2017, Table 3, [https://www.ey.com/Publication/vwLUAssets/ey-total-state-and-local-business-taxes-2016/\\$File/ey-total-state-and-local-business-taxes-2016.pdf](https://www.ey.com/Publication/vwLUAssets/ey-total-state-and-local-business-taxes-2016/$File/ey-total-state-and-local-business-taxes-2016.pdf).

FIGURE 6a.
State and Local Property Tax Collections per Capita, FY 2015

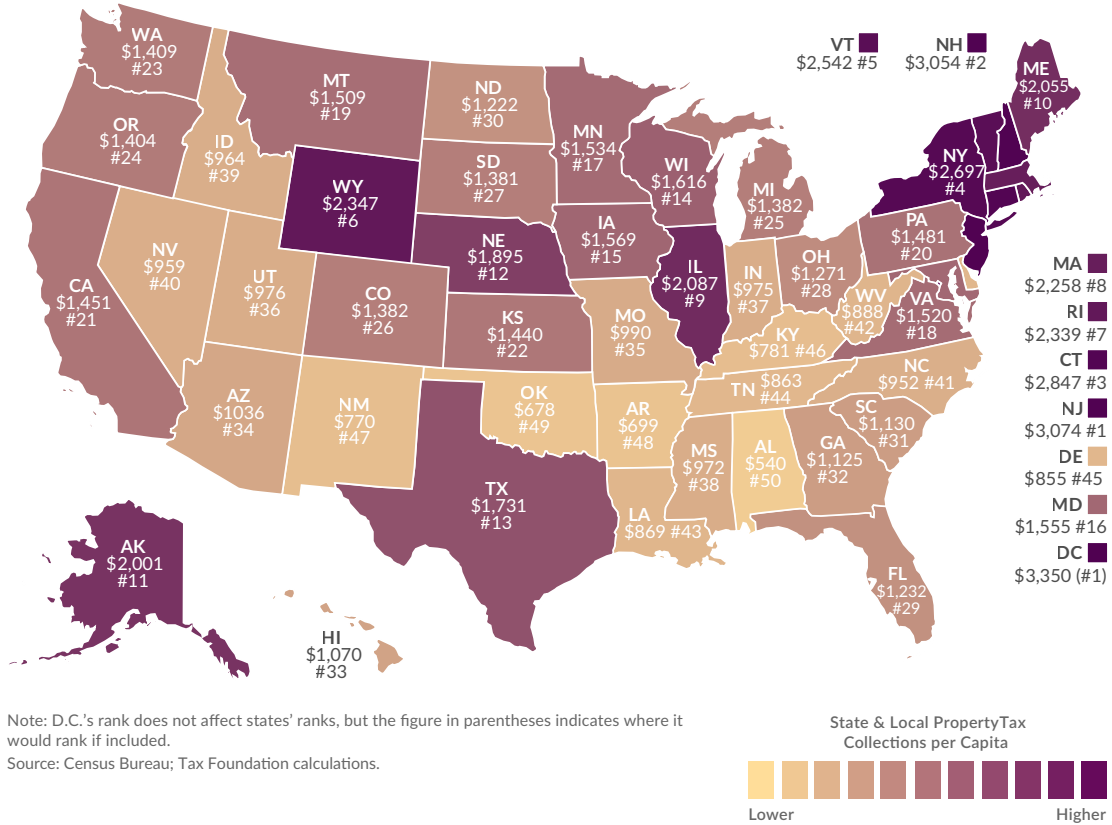
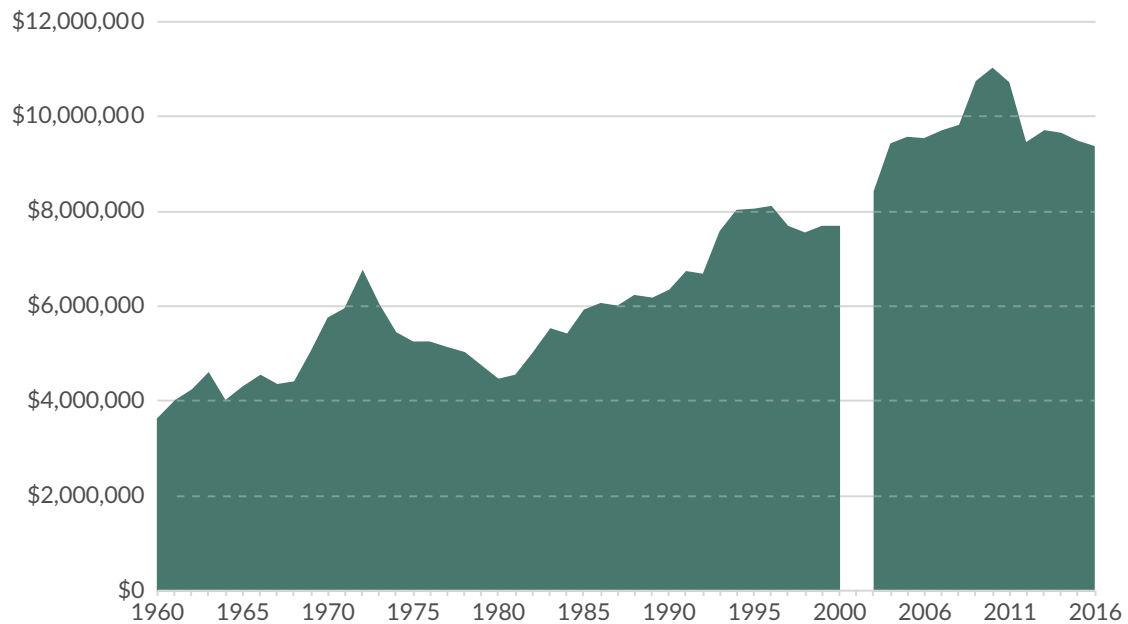


FIGURE 6b.
Wisconsin State and Local Property Tax Collections, 1960-2016
(in Thousands of 2016 dollars)



Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2016 base year. Data for 2001 is not available.
 Source: Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, *Consumer Price Indexes (All Urban Consumers)*.

Property Tax Structure

While tax collections are an important indicator for states, more important is the tax structure, including the tax base (what is taxed) and the tax administration (how it is collected). When accounting for these other items, Wisconsin ranks middle of the pack nationally.

In our 2019 *State Business Tax Climate Index*, Wisconsin performs well compared to neighboring states, ranking 21st on this component (Table 6a). Only Indiana scores better in the region (2nd), and Illinois ranks notably worse (45th). Notably, Wisconsin goes without some duplicative and distortive taxes on property used elsewhere, such as estate and inheritance taxes, taxes on intangible property, taxes on inventory, or capital stock taxes.

TABLE 6a.
2019 State Business Tax Climate Index
Property Tax Component Rankings

Wisconsin and Neighboring States	
State	Component Ranking
Wisconsin	21st
Illinois	45th
Indiana	2nd
Iowa	39th
Michigan	22nd
Minnesota	31st

Source: Tax Foundation, 2019 *State Business Tax Climate Index*.

State Mechanisms Aimed at Reducing Property Tax Burdens

Though the property tax is a local levy, disgruntled voters throughout the state's history have successfully lobbied state legislators to institute a host of state-run programs to try to reduce the property tax burden. While many programs involve using the state income tax, the state also delivers cash transfers to localities through its "shared revenue" program.

State-Provided Property Tax Credits and Programs

In response to high property tax burdens, Wisconsin allows a variety of credits against property tax liability, reducing both income and property taxes in relation to one's property tax bill. Unfortunately, such credits are often more effective at shifting or disguising tax burdens than actually reducing them.

When taxpayers are permitted a credit against income tax liability for property taxes paid, the state must impose higher income tax rates than it would otherwise. Wisconsin's levy limits (discussed below) constrain any impulse this might create for localities to raise property taxes knowing that state government will offset part of the burden, though this aid does have the effect of reducing incentives for local tax relief. Fundamentally, these credits represent a tax shift, with income and other state-level tax dollars used to provide tax reductions for property owners whose property taxes are ostensibly paying, at least in part, for local schools and local services associated with property ownership.

Wisconsin currently offers three credits against property tax burdens on individual income tax returns:

- the School Property Tax/Rent Credit, which provides taxpayers with a 12 percent credit up to \$2,500 on their property tax liability against their state income tax liability (worth \$412 million in 2017)¹¹⁰;
- the Homestead Credit, an income tax credit available for property taxes paid by taxpayers below \$24,680 in household income (worth \$98 million)¹¹¹; and
- the Veterans and Surviving Spouses Property Tax Credit, an income tax credit for disabled veterans or surviving spouses equal to the full amount of their property taxes on their primary residence (worth \$25 million).¹¹²

110 Wisconsin Department of Revenue, "Summary of Tax Exemption Devices," February 2017, <https://www.revenue.wi.gov/DORReports/17sumrpt.pdf>.

111 Ibid.

112 Ibid.

Three further credits are applied directly against property tax liability:

- a School Levy Tax Credit, which reduces school district liability, with the state wholly reimbursing school districts for revenue lost to the credit (\$940 million)¹¹³;
- the First Dollar Credit, which apportions a grand total of \$150 million among property owners to reduce their school district taxes by an average of \$66 per return¹¹⁴; and
- the Lottery and Gaming Credit, a property tax credit available to taxpayers on their primary residence and funded by the state’s lottery program (hence the name) for an average credit of \$116 (worth \$172 million statewide).¹¹⁵

State Aid in the Form of “Shared Revenue”

Another sizable linkage between the state and local governments designed in part to reduce property tax burdens is the “shared revenue” program. Originally conceived in 1911 in conjunction with the state income tax, the system today amounts to a significant transfer of state tax revenue to local governments based on special (often complex) formulas. Total disbursements in 2017 were \$822 million to counties and municipalities, \$668 million of which went to municipalities and \$154 million to counties.¹¹⁶ Shared revenue distributions represent the fourth largest appropriation in the general fund budget, after school aid, medical assistance, and the University of Wisconsin system.¹¹⁷

Wisconsin’s shared revenue system is intended in part to equalize tax bases across the state. As designed, the system favors local governments with higher per capita expenditures and can undercut localities’ incentive to attract industry or prioritize economic expansion. Like the aforementioned credits, it reduces property tax burdens—in this case by providing an alternative revenue stream—by shifting a greater share of tax collections to the state level.

Removing Items from Property Tax Funding

In other cases, the state has explicitly removed expenditures from local property taxes. In 2014, the state legislature provided \$406 million in funding to the Wisconsin Technical College System to finance technical colleges throughout the state.¹¹⁸ Previously, they had been funded by local property taxes.

113 Wisconsin Department of Revenue, Division of Research and Policy, “State School Levies Credit,” Nov. 30, 2018, <https://www.revenue.wi.gov/DORReports/schlevcredit.pdf>.

114 Wisconsin Department of Revenue, Division of Research and Policy, “First Dollar Credit,” Nov. 30, 2018, <https://www.revenue.wi.gov/DORReports/fdc.pdf>.

115 Wisconsin Department of Revenue, Division of Research and Policy, “Lottery and Gaming Tax Credit,” Nov. 30, 2018, <https://www.revenue.wi.gov/DORReports/ltrycr.pdf>.

116 Wisconsin Department of Revenue, Division of Research and Policy, “County and Municipal Aid,” Nov. 19, 2018, <https://www.revenue.wi.gov/DORReports/munico.pdf>.

117 Wisconsin Legislative Fiscal Bureau, “Shared Revenue Program,” January 2003, 1, https://docs.legis.wisconsin.gov/misc/lfb/informational_papers/january_2003/0018_shared_revenue_program_shared_revenue_and_county_mandate_relief_informational_paper_18.pdf.

118 Wisconsin Legislative Council Act Memo, “2013 Wisconsin Act 145, Income Tax Rates and Technical College District Revenue,” March 26, 2014, <https://docs.legis.wisconsin.gov/2013/related/lcactmemo/act145>.

Levy Limitations

Wisconsin property taxes levied by school districts, municipal governments, and county governments are subject to strict limits on revenue growth, essentially only permitting collections to rise with voter approval.

A limit on total revenue growth for school districts applies to the sum of state aid and property taxes and has been in effect since 1993. Initially, the legislature set the permissible increase each year, but a zero percent policy has now been made permanent. If state aid increases, property taxes must decline, and they can only increase if state aid declines. Total revenues may only increase if voters adopt a referendum that overrides the levy limit.¹¹⁹ Between 2002 and 2012, 599 override referenda were held across the state, 47.6 percent of which were approved. In some cases, voters were faced with several override options on the same ballot; of the 483 times voters were asked to override revenue limits, they approved at least one override 54.9 percent of the time.¹²⁰

Municipal and county governments have a relatively new levy (or revenue) limit, which has been in effect since 2005. This levy limit applies only to the property tax (and not state aid), requiring that increases in property tax levies do not exceed the increase in property values from new construction. This cap limited revenue growth to 1.71 percent in 2015.¹²¹

Levy limits tend to be more economically efficient than other forms of property tax limitations, like assessment and rate limits. Assessment limits, designed to keep individual property owners' tax burdens from rising, can introduce significant distortions, with similarly situated properties subject to radically different tax burdens. They also influence decisions about whether to improve or sell a property, decisions which are unaffected by a levy limit.¹²² Unlike a rate limit, moreover, levy limits are not easily circumvented by local governments. Wisconsin's levy limits are strict and over time lead to a reduction in property tax burdens in real terms unless voters authorize an increase.

Consequences of Property Tax Relief Measures

Property taxes are among the more economically neutral taxes, demonstrating a much smaller influence on economic decision-making than most alternative modes of taxation.¹²³ As an immobile asset, tax competition and tax avoidance activities arising from property taxation are less pronounced than they would be from other available tax options.¹²⁴ At the margin, income taxes discourage labor and investment and may induce inefficient efforts at avoidance. Many other taxes pick winners and losers by favoring or disfavoring a range of economic activities. Property taxes, by contrast, tend to be more

119 Andrew Reschovsky, "Wisconsin: Significant Features of the Property Tax," 3.

120 Lindsay Amiel, Jared Knowles, and Andrew Reschovsky, "The Political Economy of Voter Support for School Property Taxation," Lincoln Institute of Land Policy, June 2016, 4, <https://www.lincolnst.edu/sites/default/files/pubfiles/wp16la1.pdf>.

121 Andrew Reschovsky, "Wisconsin: Significant Features of the Property Tax," 3.

122 See generally, Jared Walczak, "Property Tax Limitation Regimes: A Primer," Tax Foundation, Apr. 23, 2018, <https://taxfoundation.org/property-tax-limitation-regimes-primer/>.

123 Jens Matthias Arnold, Bert Brys, Christopher Heady, Heady, Åsa Johansson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy for Economic Recovery and Growth," *The Economic Journal* 121, no. 550 (Feb. 1, 2011).

124 For a discussion of strategic competition in property tax regimes, see Jan K. Brueckner and Luz A. Saavedra, "Do Local Governments Engage in Strategic Property-Tax Competition?"

economically neutral.¹²⁵ While property taxes are not always popular, reforms to more economically destructive taxes, such as individual and corporate income taxes, should be the first priority in Wisconsin.

Property taxes also come closer than most other taxes to passing the benefit test, whereby taxes paid roughly correlates with benefits received. However imperfect, the value of one's property is a better proxy for the value of local services received than most alternative tax bases. More than at other levels of government, local services often align closely with property and property values. Roads, utilities, police and fire protection, and local public amenities all increase or preserve the value of property, and, if supplied privately, would likely increase in worth with higher property values.¹²⁶ If, therefore, aggressive property tax limitations drive localities to shift to alternative revenue options, or extensive state credits and offsets increase reliance on less competitive state-imposed taxes, the net economic effect may be negative.

Personal Property Taxes

Wisconsin exceeds many of its peers in limiting the reach of outmoded taxes on tangible property, though there remains work to do. Over the years, the tangible personal property tax has declined in importance as a source of revenue, and it is ripe for elimination.

Tangible personal property is anything that can be touched and moved. It differs from real property, which is land, buildings, and fixtures. The two property tax classifications also differ in that real property taxes are taxpayer-passive, meaning that an assessor mails the taxpayer a completed return which they pay, and personal property taxes are taxpayer-active, meaning that the taxpayer must fill in the return themselves, tallying all their personal property and calculating its depreciation according to a schedule. Real property tax returns are entered into the public record, while personal property tax returns are kept confidential.¹²⁷

Historically, personal property taxes were levied throughout the country, including on homestead property like the refrigerators and couches in peoples' residences. Ostensibly, auditors could enter a taxpayer's home to inspect these personal effects and determine their assessed value. Unsurprisingly, this intrusive application of personal property taxes to homestead property was highly unpopular, and the practice went virtually extinct nationwide as income and sales taxes came into more frequent use following the Great Depression.¹²⁸

125 Bruce Wallin and Jeffrey Zabel, "Property Tax Limitations and Local Fiscal Conditions: The Impact of Proposition 2½ in Massachusetts," Lincoln Institute of Land Policy Working Paper, 4.

126 Ibid., 4-5.

127 Wisconsin Department of Revenue, "2019 Guide for Property Owners," 11, <https://www.revenue.wi.gov/DOR%20Publications/pb060.pdf>.

128 Joyce Errecart, Ed Gerrish, and Scott Drenkard, "States Moving Away From Taxes on Tangible Personal Property," Tax Foundation, Oct. 4, 2012, <https://taxfoundation.org/states-moving-away-taxes-tangible-personal-property/>. It should also be noted that some states do still apply personal property taxes to nonbusiness vehicles, and that those taxes are widely levied. See Jared Walczak, "Jim Gilmore's Car Tax Repeal Plan, 18 Years Later," Tax Foundation, July 30, 2015, <https://taxfoundation.org/jim-gilmores-car-tax-repeal-plan-18-years-later/>.

Though states forgo taxes on homestead personal property, taxes on business personal property remain common, even though they fit uncomfortably within a modern tax code. A 2012 study found that 32 states employ business personal property taxes to some degree, though many, including Wisconsin, have sought to reduce their reliance on the tax type in the last 20 years.¹²⁹

Taxes on personal property are generally found to be economically harmful, as they can discourage business investments that help increase productivity and business expansion. Fortunately, Wisconsin has eliminated tangible personal property taxes on many classes of property, including most of those with the most substantial business impact. Inventories were exempted in 1960, manufacturing machinery and equipment were exempted in 1973,¹³⁰ and under recent legislation, other machinery, tools, and patterns were exempted as of January 1, 2018.¹³¹

Today, Wisconsin continues to tax:

- boats and watercraft;
- furniture, fixtures, and office equipment;
- leased equipment, building on leased land, and signs and billboards;
- fax machines, copiers, postage meters, and telephone systems; and
- other supplies.¹³²

While the state has made significant progress in this area, ideally, the state would exempt all tangible personal property from its tax base.

129 Joyce Errecart, Ed Gerrish, and Scott Drenkard, "States Moving Away From Taxes on Tangible Personal Property."

130 Jack Stark, "A History of Property Tax and Property Tax Relief in Wisconsin," Wisconsin Blue Book 1991-1992, Legislative Reference Bureau, <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.220.3827&rep=rep1&type=pdf>.

131 Wisconsin Department of Revenue, Division of Research and Policy, "Property Tax Overview," Nov. 7, 2018, <https://www.revenue.wi.gov/DORReports/ProTax.pdf>.

132 2019 Wisconsin Statement of Personal Property, PA-003 (R. 12-17), <https://www.revenue.wi.gov/DORForms/pa-003.pdf>.

Property Tax Administration

The Council on State Taxation (COST) releases a report annually detailing the property tax administration practices of the 50 states, in addition to giving each state's system a letter grade based on its practices. According to COST:

[I]t is essential for state legislators and tax administrators to ensure the tax is administered fairly and without perceptions of bias or undue administrative burdens. Taxpayers are much more willing to fairly and fully comply with a property tax system perceived as unbiased, equitable and efficient.¹³³

States are evaluated based on whether they have a uniform tax base and rates, adopt efficient filing procedures, centralize review and uniform appeal procedures, and limit payment requirements to the uncontested portion of valuations.¹³⁴

Based on these criteria, Wisconsin receives a grade of C-. A range of factors contributes to this score, including the wide variation in local property valuation cycles (the ideal is every two to three years), the lack of an exclusion for *de minimis* values, and hefty interest rates for delinquent payments.

133 Fredrick J. Nicely, "The Best and Worst in Property Tax Administration," Council on State Taxation (COST), May 2011, 1, <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/cost-scorecard--the-best-and-worst-of-property-tax-administration.pdf>.

134 *Ibid.*, 2.

Property Tax Solutions

The following property tax solutions are designed to improve Wisconsin's property tax system to be more competitive while still providing revenue for necessary local government services. State-financed property tax swaps are frequently inefficient and economically undesirable, so we recommend against any expansion of the state's already generous system of property tax offsets. Our options balance the desire for property tax improvement with the demand for continued revenues.

Continue Toward Repeal of Personal Property Tax

Wisconsin has made notable strides in improving treatment of business personal property like machinery and tools under the property tax code. The state should continue to exempt new classes of personal property from tax with the goal of total repeal of tangible property taxes. Such a policy would reduce the cost of capital accumulation and, by extension, the cost of doing business in the state—both directly (through reduced tax liability) and indirectly (through reduced compliance costs). With the strides Wisconsin has already taken, the tax has lost much of its significance. Repeal—or further movement in the direction of repeal—is a logical next step.

Allow Property Tax Limits to Continue Working

Wisconsin should avoid the temptation to increase reliance on property tax credits, and perhaps even reduce such offsets over time. Such programs divorce local spending from local revenue collection and enhance reliance on less competitive taxes. The property tax caps in Wisconsin have been effective in reducing overall burdens in recent years and should be allowed to continue working.

CHAPTER 7

**ADDITIONAL IMPORTANT
CONSIDERATIONS**



Introduction

Wisconsin's tax and budget system includes some additional considerations that are outside the topics already discussed but merit attention in reform conversations. The most formidable of these is the state's transportation system, where the value of the state's gas tax is falling behind historical averages while spending is increasing. This chapter also suggests Wisconsin explore tolling as another way to generate adequate revenue for transportation.

Wisconsin's unemployment insurance tax system is uncompetitive with high rates and a complex structure. The state's top rate is the fifth highest nationally and includes an additional surtax on firms. An uncompetitive unemployment insurance structure makes it difficult for in-state employers to expand or innovate as firms that struggle are the firms that are punished the most.

Finally, we discuss the tax reform practice of using revenue triggers to phase in tax reforms so that revenue stability is maintained while moving the state toward a more comprehensive tax system. Several states have implemented revenue triggers and provide ample examples to craft a trigger tailored for Wisconsin.

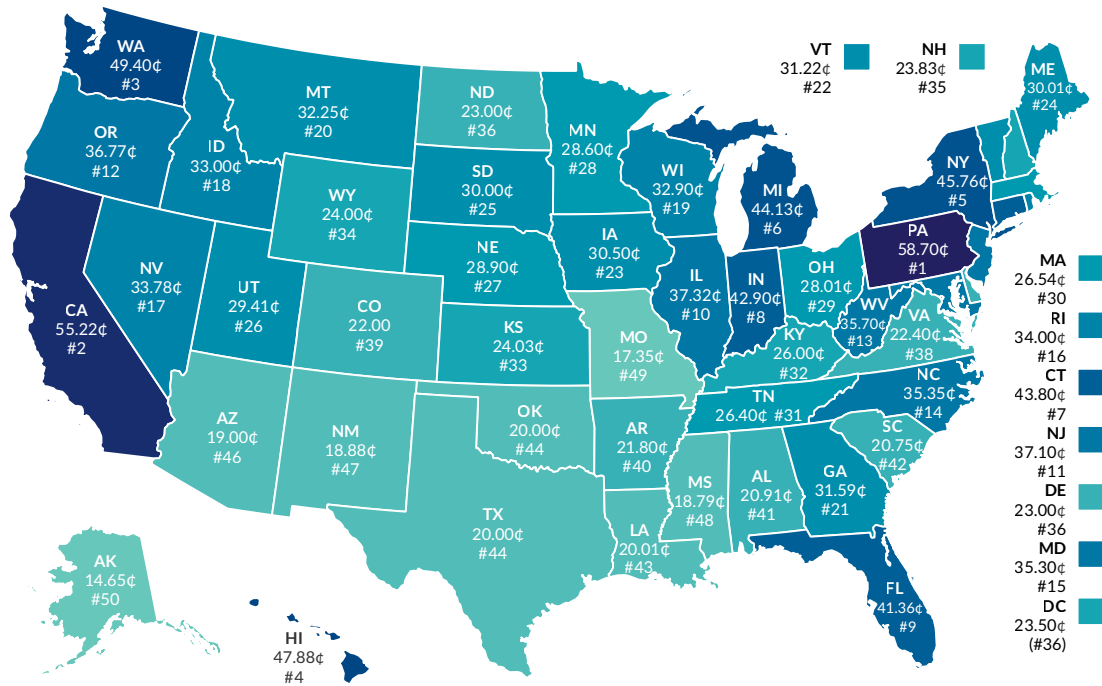
Transportation Funding in Wisconsin

The Wisconsin gasoline tax today stands at 32.9 cents per gallon (cpg), the 19th highest rate in the country (Figure 7a). Because state motor fuel taxes are usually imposed as an excise of a given amount per gallon, and tend not to be indexed for inflation, tax collections tend to decline in real terms over time. Wisconsin is no different in this regard, as shown in Figure 7b.

FIGURE 7a.

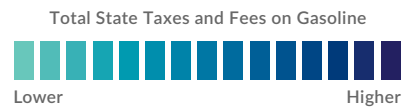
State Gasoline Tax Rates

Total State Taxes and Fees on Gasoline, as of July 2018 (cents per gallon)



Notes: These rates do not include the 18.40 cent/gallon federal excise tax on gas. The American Petroleum Institute (API) has developed a methodology for determining the average tax rate on a gallon of fuel. Rates may include any of the following: excise taxes, environmental fees, storage tank taxes, other fees or taxes, and general sales tax. In states where gasoline is subject to the general sales tax, or where the fuel tax is based on the average sale price, the average rate determined by API is sensitive to changes in the price of gasoline. States that fully or partially apply general sales taxes to gasoline are California, Connecticut, Georgia, Illinois, Indiana, Michigan, and New York. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.

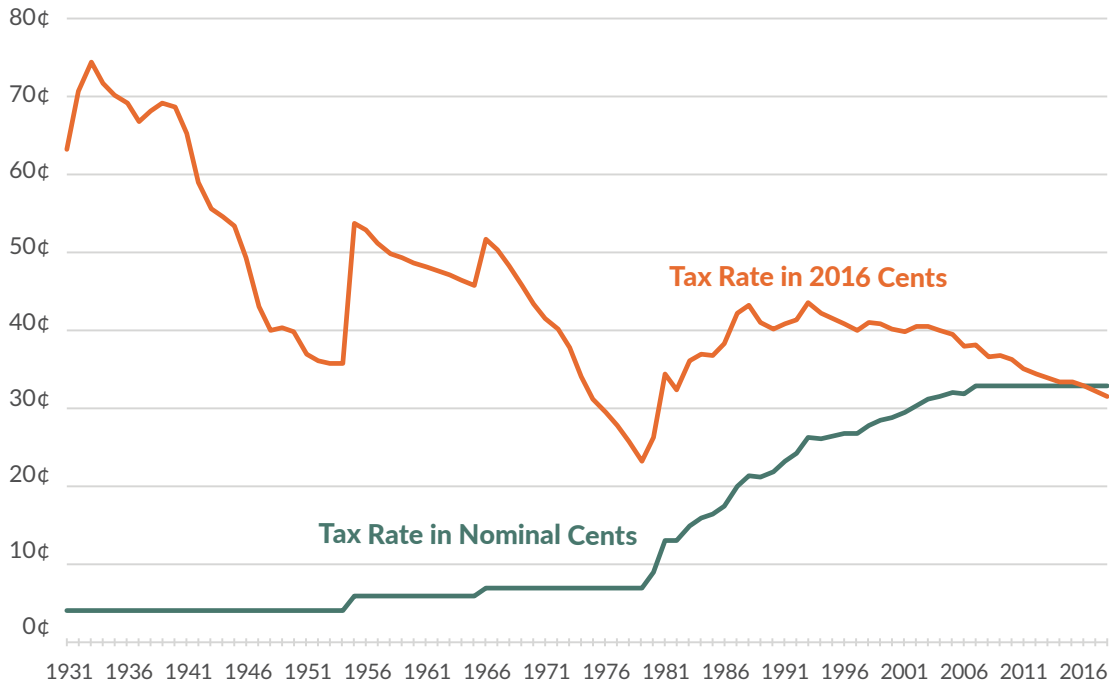
Source: American Petroleum Institute.



ADDITIONAL IMPORTANT CONSIDERATIONS

CHAPTER 7

FIGURE 7b.
Wisconsin Gasoline Tax Rate, 1931-2018 (Cents per Gallon)



Note: The state also charges a 2 cent per gallon tax for underground storage of fuels. It is not included above.
 Source: Wisconsin Statutes; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

Because the state has raised its gas tax rate infrequently, the value of the tax has declined in real terms. In 1933, the tax peaked at 77.6 cents per gallon in inflation-adjusted terms. While Wisconsin has changed its rate several times since then, the state hasn't raised the rate since 2006. The current rate of 30.9 cpg is now well below the state's average rate. Since World War II, the average inflation-adjusted rate is 40.6 cpg. Not adjusting the rate makes it more difficult to finance transportation spending, as the gas tax revenue doesn't go as far as it could in the past.

Additionally, cars are becoming more fuel efficient, meaning they need fewer gallons of gas to travel the same distance. That further erodes the value of the gas tax, since the tax is assessed on the number of gallons dispensed.

Gas taxes are not a perfect option for funding transportation investments but do serve as a reasonable addition to a mix of transportation funding options.

Minimum Markup on Gasoline

In addition to the state’s excise tax on gasoline sales, the state also mandates the markup that retailers and wholesalers must charge on the product.

In 1939, the Unfair Sales Act, commonly referred to as the “minimum markup law,” was adopted in Wisconsin. Originally designed to prevent businesses from using predatory pricing to defeat their competitors and gain a monopoly, this Depression-era law remains on the books to this day, artificially inflating gas prices beyond what most retailers would like to charge.

Specifically, the Unfair Sales Act prevents Wisconsin brick-and-mortar stores from selling any good “below cost,” and the law outlines a specific markup formula for gasoline, tobacco, and alcohol.¹³⁵ The markup is calculated by adding 2 cents to the invoiced price (with revenue used for transportation funding) before adding federal, state, and local taxes. After taxes are added, wholesalers are required to mark up the price by 3 percent, and retailers by an additional 6 percent, for a total markup of 9.18 percent. Currently, less than half the states have this antiquated policy.¹³⁶

Proponents of minimum markup policies argue that they prevent retailers and gas stations from pricing their products below value to attract consumers and eliminate competition (predatory pricing). But there is little evidence that minimum markup policies are successful at accomplishing that goal. A recent study, for example, compared the number of small gas stations in states with and without minimum markup laws. The authors argue that “the presence of a minimum markup law has no impact on the number of gas stations in a state.”¹³⁷ They continue arguing more strongly that the provision “does nothing to achieve its ostensible goal of protecting small independent retailers from excessive competition.”¹³⁸ Instead, the provision “increased the profit margin”¹³⁹ for gas stations, meaning this law results in higher prices for consumers.

Highway System in Wisconsin

Wisconsin’s Department of Transportation is responsible for maintaining 12,000 miles of state highways. In the 2015-2016 fiscal year, the state spent more than \$2 billion on construction, planning, maintenance, and other expenses.¹⁴⁰ From fiscal year 1996-97 to fiscal year 2015-16, spending by the Department of Transportation increased by 190 percent.¹⁴¹ Even with the increase, the state has inadequate funding for transportation. In a 2013 report, it was estimated that the Department of Transportation would need annual increases of \$1.3 billion from 2014 to 2023 to keep pace with the state’s maintenance needs.¹⁴²

135 Wisconsin Stats. 100.30.

136 Will Flanders and Ike Brannon, “A Policy in Search of a Problem,” Wisconsin Institute for Law & Liberty, May 2017, 4.

137 Ibid, 11.

138 Ibid, 11.

139 Ibid, 11.

140 Wisconsin Legislative Audit Bureau, “State Highway Program,” Report 17-2, January 2017, <https://legis.wisconsin.gov/lab/media/2591/17-2full.pdf>.

141 Ibid, 3.

142 Mark Sommerhauser, “Wisconsin’s Transportation-Funding Problem: Possible Solutions; and How We Got Here,” *Wisconsin State Journal*, Jan. 22, 2017, https://madison.com/wsj/news/local/govt-and-politics/wisconsin-s-transportation-funding-problem-possible-solutions-and-how-we/article_d731ea7f-fd53-5907-92f6-813406b8b8f8.html.

Over the past decade, the condition of the Wisconsin state highway system has worsened. In 2010, 53.5 percent of state highways were ranked in “good condition,” compared to 41 percent in 2015.¹⁴³ Compared to its neighboring states, Wisconsin’s road condition was “considerably lower” in 2014.¹⁴⁴

As those two facts illustrate, Wisconsin is not necessarily the most cost-effective in its management of the state’s road funding. A report from the Reason Foundation said Wisconsin had the 38th best performance and cost effectiveness of any state in its oversight of the highway system. The report noted that Wisconsin’s per mile spending increased as the condition of roads worsened.¹⁴⁵

Tolling Offers a New Revenue Source

The state should explore raising its gas tax to restore the inflation-adjusted value of the revenue source, as well as tie the rate to inflation so future adjustments happen automatically. But that change should not be the only one explored by policymakers in the state. Tolling is another smart solution to generating the revenue needed for transportation maintenance and expansion.¹⁴⁶ The difficulty, however, is that tolling on interstate highways requires federal authority. While the federal government has created several pilot programs to expand the use of tolling, approval is difficult to achieve.¹⁴⁷

Unemployment Insurance Taxes

Wisconsin’s unemployment insurance (UI) tax ranks just above Illinois among the 10 lowest-ranked UI tax systems on our *State Business Tax Climate Index*, reflecting high rates and an uncompetitive structure. By contrast, Minnesota and Iowa’s UI systems rank in the middle of the pack, while Indiana’s ranks 11th best in the nation.

TABLE 7a.
2019 State Business Tax Climate Index
Unemployment Insurance Component Rankings

Wisconsin and Neighboring States	
State	Component Ranking
Wisconsin	41st
Illinois	42nd
Indiana	11th
Iowa	33rd
Michigan	49th
Minnesota	25th

Source: Tax Foundation, 2019 *State Business Tax Climate Index*.

143 Ibid, 4.

144 Ibid, 4.

145 M. Gregory Fields, Baruch Feignbaum, and Spence Purnell, “Ranking the Best, Worst, Safest, and Most Expensive State Highway Systems—The 23rd Annual Highway Report,” Reason Foundation, Feb. 8, 2018, <https://reason.org/policy-study/23rd-annual-highway-report/>.

146 Robert Poole Jr., “Rebuilding and Modernizing Wisconsin’s Interstates with Toll Financing,” Badger Institute 24, no. 7 (October 2011), <https://www.badgerinstitute.org/Reports/2011/Rebuilding-and-Modernizing-Wisconsins-Interstates-with-Toll-Financing.htm>.

147 Mike Nichols, “Look down the road in transportation funding debate,” Badger Institute, July 19, 2017, <https://www.badgerinstitute.org/Commentary/Look-down-the-road-in-transportation-funding-debate.htm>.

UI taxes are unique, as rates are computed for each company based on their characteristics, rather than being applied at a uniform rate (or rate schedule) on all businesses. Each year, the Wisconsin Department of Workforce Development computes a contribution tax rate for each employer based on the employer’s “experience” in hiring and employment retention. Firms that lay off more workers pay higher rates to approximate their usage of the unemployment compensation system. This tax is not levied on all employee compensation, but on the taxable wage base, which is presently \$14,000 per employee.

Under current law in Wisconsin, firms pay rates between 0.05 percent and 12 percent on the taxable wage base, yielding high effective tax rates compared to most states.

Before employers can qualify for an experience rating, they must endure a waiting period. Wisconsin’s three-year waiting period is among the longest; only Nevada’s waiting period is longer, at 3.5 years, while 34 states have waiting periods of less than three years.¹⁴⁸ During this waiting period, new employers pay a set “new employer” rate, which is often higher than what they will later pay.

Unlike other states, Wisconsin uses a two-tiered UI tax rate system for new employers, injecting additional complexity into an already complicated tax structure. New employers with total taxable payroll lower than \$500,000 pay a lower-rate UI tax, while those with taxable payroll greater than \$500,000 pay a higher-rate tax. The new employer rate is consistent across every industry except construction, to which a higher rate is applied.¹⁴⁹

Other factors serve to ratchet up liability—even for employers with solid track records—based on the state of the economy and the solvency of the unemployment compensation fund. If the state is forced to borrow from the federal government to make payments, moreover, businesses in Wisconsin are responsible for an additional “interest factor.” Surcharges and solvency measures are understandable, but they are also an admission of a program’s shortcomings. It would be far better for the state to accumulate reserves in prosperous years than to continue its current practice of hiking rates just as businesses are struggling to make payroll.

A well-structured unemployment compensation system prioritizes stability; by contrast, with its solvency tax layered atop a surtax, Wisconsin’s system follows, rather than anticipates, the business cycle. Wisconsin’s rates are high enough during an up economy; during a downturn, the even higher rates impose heavy burdens on the very businesses that are struggling to avoid layoffs. Policymakers would do well to rebalance rates, benefits, and structure to make the system more competitive.

148 Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, *2019 State Business Tax Climate Index*, Tax Foundation, Sept. 28, 2018, Table 19.

149 Wisconsin Department of Workforce Development, “Unemployment Insurance 2019 Tax Rates,” accessed Nov. 26, 2018, <https://dwd.wisconsin.gov/ui/employers/taxrates.htm>.

Tax Triggers

Tax triggers are a new take on an old concept: contingent enactment of a legislative provision. States have long relied upon bills with contingent enactment clauses, providing that certain features of new legislation shall only be operative if certain conditions are met. Tax triggers build on this model, making tax reform measures contingent on state revenues meeting or exceeding established targets.

Tax triggers can help ensure revenue stability and limit the uncertainty associated with changes to the tax code while providing an efficient way for states to dedicate some portion of revenue growth to tax relief. States are increasingly turning to tax triggers as a component of tax reform measures.¹⁵⁰ As noted in Chapter 5, Wisconsin has a small tax trigger, based on collections from its sales tax on remote sellers. Revenues will be used to lower individual income tax rates. The state also diverts “half of the difference between expected and annual revenue” to its rainy-day fund, a reasonable approach to ensuring that rainy-day balances are built up during periods of economic expansion to fund government services during economic downturns.¹⁵¹

These two provisions are a small step in balancing the need for revenue availability with the need for tax reforms, but as these states that follow illustrate, the use of tax triggers can be quite robust. As policymakers in Wisconsin look to reform the state’s tax code, tax triggers could be an essential element of that reform.

- **Massachusetts** voters in 2000 ratified a phase-in of tax cuts designed to reduce the state’s individual income tax rate from 5.95 to 5.0 percent over three years, but the reductions were frozen by the legislature in 2002 at a rate of 5.3 percent. As a compromise, the legislature agreed to allow further reductions to a 5.0 percent rate to proceed, but only after a series of increases to the personal exemption had been implemented, and at a pace of 0.05 percent per year, contingent upon state tax revenues having grown at least 2.5 percent faster than the rate of inflation.
- **Michigan**, as part of a larger tax reform package enacted in 2015, is set to begin implementing income tax reductions in fiscal year 2023. Although several states have delayed implementation until several years after enactment, Michigan’s eight-year deferral is unusual in its length. Following any year in which there is inflation-adjusted general fund/general purpose revenue growth, the individual income tax rate is to be reduced by an amount calculated by an equation which captures a portion of cumulative inflation-adjusted revenue growth over fiscal year 2021 collections. The income tax rate would be reduced proportionately by the amount which the prior year’s general fund revenue exceeded inflation-adjusted fiscal year 2021 revenue, multiplied by a statutorily set adjustment factor of 1.425 and divided by total income tax revenue. Competing legislation would have utilized year-over-year revenue growth rather than a cumulative measure of inflation to trigger tax cuts.

150 Excerpted from Jared Walczak, “Designing Tax Triggers: Lessons from the States,” Tax Foundation, Sept. 7, 2016, <http://taxfoundation.org/article/designing-tax-triggers-lessons-states>.

151 The Pew Charitable Trusts, “Building State Rainy Day Funds,” July 2014, 8, https://www.pewtrusts.org/~media/assets/2014/07/sfh_rainy-day-fund-deposit-rules-report_artready_v9.pdf.

- **North Carolina** adopted comprehensive tax reform in 2013. That year's legislation saw substantial individual income, corporate income, and sales tax reform, along with the repeal of the estate tax, relying on triggers for some of the corporate income tax reductions. The 2013 legislation cut the corporate income tax rate from 6.9 percent to 6.0 percent while broadening the tax base by reducing certain tax credits and exemptions and scheduled a further reduction to 5.0 percent in 2014. Subsequent reductions, however, were made contingent on achieving statutorily-set revenue targets. Initially, the law established that if net general fund tax collections for the 2015 fiscal year exceeded \$20.2 billion, the tax rate would be reduced by one percentage point, with a similar provision in place should revenue exceed \$20.975 billion in fiscal year 2016. In 2015, after the first triggered reduction had been implemented, the General Assembly adopted further reforms, including an additional individual income tax rate reduction. Believing that these tax changes would delay reaching \$20.975 billion in revenue, the legislature removed the timeline, stipulating that the second triggered reduction would be implemented whenever net general fund revenues exceeded the benchmark figure, whether in fiscal year 2016 or thereafter. The adjustment notwithstanding, robust revenue growth has North Carolina on track to certify the 3.0 percent rate for the 2017 tax year.
- The **District of Columbia** in 2014 approved a tax reform package which reduced corporate and individual income tax rates, adopted more generous standard deductions and personal exemptions, and expanded the Earned Income Tax Credit, among other changes. Additional tax reform priorities were made contingent upon midyear annual revenue estimates exceeding preliminary annual revenue estimates, with any additional monies in fiscal years 2015 and 2016 funneled into implementation of as many as 17 tax reform provisions, addressed in order of priority.

Well-designed triggers ensure that benchmarks reflect meaningful revenue growth, rather than capturing a rebound from a year of weak revenues or the effects of inflation. They also avoid undue time constraints which can derail, rather than delay, the implementation of a program of contingent reforms. When properly constructed, tax triggers serve as a valuable mechanism for implementing responsible tax reform.

ABOUT THE TAX FOUNDATION

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and local levels. Our Center for State Tax Policy uses research to foster competition among the states and advises policymakers on how to improve their tax systems.

Center for State Tax Policy

Joseph Bishop-Henchman

Executive Vice President, Legal & State Projects

Nicole Kaeding

Economist & Director of Federal Projects

Jared Walczak

Senior Policy Analyst

Katherine Loughhead

Policy Analyst

Publications

Rachel Shuster

Editor

Dan Carvajal

Designer

Special thanks to Scott Drenkard, Erica York, Garrett Watson, Scott Eastman, and Colin Cook for their research assistance.

THE BADGER INSTITUTE

The Badger Institute, formerly the Wisconsin Policy Research Institute, is a nonpartisan, not-for-profit institute established in 1987 working to engage and energize Wisconsinites and others in discussions and timely action on key public policy issues critical to the state's future, growth and prosperity. The institute's research and public education activities are directed to identify and promote public policies in Wisconsin that are fair, accountable and cost-effective.

The Badger Institute is guided by a belief that competitive free markets, limited government, private initiative and personal responsibility are essential to our democratic way of life.

Wisconsin has struggled with its tax system for decades. The state has always been marked by high property tax burdens, but in its effort to “fix” them has leaned on corporate and individual income taxes to a sizable degree as well.

Wisconsinites are often flummoxed by why taxes are so high here—government services have a good reputation, but it isn’t always clear they are worth the price tag. Still other taxpayers feel they should be grateful as at least fiscal matters aren’t in as dire of straits as in Illinois. In recent legislative sessions, the legislature and administration have made strides to improve the roughest edges of the state’s tax system, but comprehensive tax reform has not been at the top of the agenda. We believe it ought to be.



PRINCIPLED
INSIGHTFUL
ENGAGED

The Tax Foundation is the nation's leading independent tax policy research organization. Since 1937, our research, analysis, and experts have informed smarter tax policy at the federal, state, and local levels. We are a 501(c)(3) non-profit organization.

©2019 Tax Foundation

Tax Foundation
1325 G Street, N.W. Suite 950
Washington, D.C. 20005
202.464.6200

taxfoundation.org