DEVIN LEMAHIEU

SENATE MAJORITY LEADER

April 25, 2023
Senate Committee on Universities and Revenue
Testimony on Senate Bill 1

Chairman Hutton and members of the Committee,

Thank you for holding this hearing on SB1, a plan to put Wisconsin on the path to a flat tax.

Over the last decade, we have worked to lower the tax burden in Wisconsin. But we have more work to do. A flat tax will encourage more growth in Wisconsin, it will keep more money in the pockets of our friends and families, and it will simplify our tax code and make it more equitable.

Since 2011, the Legislature has cut taxes by a cumulative $22 billion. As a result, state and local taxes as a share of personal income have fallen to the lowest level since at least 1970.

While the progress of the last decade was sorely needed, the state of Wisconsin continues to overtax its residents, as evidenced by a projected $7 billion surplus.

Not only does Wisconsin overtax its residents, Wisconsin's tax code remains uncompetitive. According to the Tax Foundation's 2022 *State Business Tax Climate Index,* Wisconsin ranks 27th overall, slightly below average, due to higher than average individual and corporate tax rates.

Surveying tax policies across the country, it's shocking how far behind Wisconsin has fallen. Only nine states have an individual income tax rate higher than Wisconsin's top rate of 7.65%. Every state between New York and California has a lower top individual income tax rate than Wisconsin, except Minnesota.

Despite what some have claimed, moving to a flat tax is not about cutting taxes for millionaires like Sarah Godlewski and Alex Lasry.

Businesses on Main Streets all across Wisconsin are subjected to Wisconsin's uncompetitive tax rates. As many as 95% of Wisconsin's businesses pay taxes under the individual income tax.

High tax rates ultimately hurt a state's ability to attract and retain family supporting jobs which ultimately hurts a state's ability to invest in programs we all support.

We've seen what uncompetitive tax rates mean for state tax collections. Last summer, Democrats in California passed a budget with a $100 billion spending increase. Now, Gov. Newsom is proposing $11 billion in spending cuts to manage the state's $22.5 billion deficit. What changed so quickly for California? Wealthier income earners are fleeing the state for more affordable places to live and run their businesses.

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Every time a business opts to invest in a lower tax state, our constituents lose out on higher wages and family supporting jobs. That is unfair tax policy and this bill fixes that inequity.

This bill will provide significant savings for middle-class families in Wisconsin. A family making $70,000 annually will see cumulative tax savings of $2,269 over the four year phase-in of the flat tax. They will save $898 every year after the flat tax is fully phased-in. That is meaningful and significant tax relief for the middle-class.

A flat tax isn't a novel idea, many other red and blue states across the country have or are moving to a flat tax. This includes states like Illinois, Iowa, Michigan, New Hampshire, and Colorado.

In 2020, Illinois put the issue of a progressive income tax before the voters. In the same election where a majority of voters supported Joe Biden, a majority of voters also rejected a progressive income tax.

Some of the criticism of this path to a flat tax has centered on the cost of this proposal. And I appreciate those concerns. Republicans have put Wisconsin on sound fiscal ground and we will not throw caution to the wind.

The $7 billion surplus gives us a unique opportunity to be innovative and bold, providing real tax relief for Wisconsinites. We've cut the bottom tax rates and now we must move towards a fairer, flatter tax code.

This will make Wisconsin more competitive, more affordable, and stronger.

This is a cut-and-dry tax cut for all Wisconsinites. This is a tax plan for *all* of Wisconsin.

Mr. Chairman, we have a once-in-a-lifetime opportunity to lead Wisconsin forward and deliver generational tax reform.

I ask for your support of SB1 and am happy to answer any questions you have.

ROBERT BROOKS

STATE REPRESENTATIVE • 60TH ASSEMBLY DISTRICT

Hearing Testimony
Senate Committee on Universities and Revenue
April 25, 2023
Room 412 East

Chairman Hutton and members of the Senate Committee on Universities and Revenue, thank you for affording me the opportunity to testify in favor of Senate Bill 1.

Since 2011, the legislature has cut taxes by a cumulative $22 billion, including eliminating several taxes entirely. By putting taxpayers before bureaucrats, state and local taxes as a share of personal income have fallen to the lowest level since at least 1970. Regardless, the state of Wisconsin continues to overtax its residents, as evidenced by a projected nearly $7 billion surplus during the current budget cycle.

Despite our work to protect taxpayers, Wisconsin's tax code remains uncompetitive and mediocre. According to the Badger Institute's Mandate for Madison, Wisconsin ranks twenty-seventh overall, slightly below average, on the Tax Foundation's 2022 *State Business Tax Climate Index,* due to higher than average individual and corporate tax rates.

Wisconsin's individual income tax rate are particularly uncompetitive. Only nine states have an individual income tax rate higher than Wisconsin's top rate of 7.65 percent. Every state between New York and California has a lower top individual income tax rate than Wisconsin, except Minnesota. Despite what some have posited about moving to a flat tax, it is not about cutting taxes for millionaires. Nearly ninety-five percent of Wisconsin businesses are structured as pass-through entities, which means small businesses throughout the state are subjected to an uncompetitive tax rate.

Even worse, thirty-one states have a top individual income tax rate that is lower than Wisconsin's third tax bracket rate of 5.3 percent. Nearly two-thirds of taxpayers, those filing individually and jointly, are taxed at this rate. In other words, Wisconsin's income tax on middle-class residents is higher than the top individual income tax rate in more than half of the states in our republic.

With remote capabilities empowering families and small businesses to relocate with ease like never before, it is critically important that Wisconsin have an individual income tax rate that is competitive with neighboring states. Senate Bill 1 achieves the aforementioned goal by moving Wisconsin to a 3.25 percent flat tax by tax year 2026. At that new rate, only eleven states will have a top individual income tax rate lower than Wisconsin.

According to the Legislative Fiscal Bureau, the estimated cumulative reduction in taxes is $4,415 over the four-year phase-in and $1,799 annually beginning in tax year 2026, compared to current law.

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With inflation crippling household budgets, the last thing hardworking families need is to give the government more of their money. Senate Bill 1 allows Wisconsinites to keep more of their hard-earned money, simplifies the state's income tax code, and will make Wisconsin a more desirable place for families, individuals, and businesses to relocate.

I am happy to answer any questions you might have regarding Senate Bill 1.

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Rep.Rob.Brooks@legis.wi.gov

To: Members of the Senate Committee on Universities and Revenue

From: Jamie Schwarz

Date: April 25, 2023

Subject: Support for Senate Bill 1

Hello, my name is Jamie Schwarz, and I have been a small business owner so far for 1 year in Oshkosh, WI. I was unable to attend this public hearing in person today, as I have patients scheduled all day, but wanted to provide my testimony to the members of the committee.

Wisconsin has long had one of the country's most progressive individual income taxes, with a top rate of 7.65% that is the eighth highest in the nation. A shift to a flat-rate individual income tax would result in a meaningful tax reduction for many businesses, which then should result in lower price growth, higher wage growth, more employment and higher shareholder value.

We need a simpler tax policy in our state so we, as small business owners, can determine exactly what we owe without having to jump through additional red tape and costs associated with calculating that number. Complicated policies cause confusion and frustration when small business owners are already oftentimes stressed and working much more than full time per week to keep their businesses afloat.

The flat tax proposal will significantly help my own business, as well as others', by allowing businesses to retain more of our own hard-earned money, in which we can then reinvest directly back into our business or help with hiring more employees or expanding our business. The flat tax is also fair, as everyone pays the same rate. The point of taxes is not to control people's behavior. Tax policy should be neutral to the economy and cause as little disruption as possible.

Thank you for your time and consideration on this flat tax proposal, and I encourage you all as committee members to vote yes and support this piece of legislation.

Sincerely,

Jamie Schwarz

Oshkosh, WI

To: Members of the Senate Committee on Universities and Revenue

From: Jason Lang, DC

Date: April 25, 2023

Subject: Support for Senate Bill 1

Hello, my name is Jason Lang, and I have been a small business owner for 21 years. I own Gateway Chiropractic in Appleton, and we serve community members, both adults and children, who need chiropractic care. I was unable to attend this public hearing in person today, as I have patients scheduled all day, but wanted to provide my input to the members of the committee.

The flat tax proposal will significantly help my business, and all small businesses, by allowing businesses to retain more of our own hard-earned money, in which we can then reinvest into raises for our employees, hiring more employees, and expanding our businesses, among others. The flat tax is also equitable, as everyone pays the same rate. No one should be punished by being taxed at a higher rate because they work hard, take a second job, or work overtime on Saturdays. All income should be treated equally. If everyone pays the same rate, it also avoids the issue of favoritism amongst legislators.

During covid, the number of patients we saw in our practice dropped by 50%, and while we have mostly recovered, we are still only back to about 85% of our pre-COVID base. Tax policy should be clear and simple so taxpayers and small businesses, without expensive lawyers and accountants, can easily calculate and pay what we owe, without being subjected to high compliance costs that waste time and money. I spend thousands of dollars per year hiring accountants to help me figure out how much I need to pay in for taxes. Simplifying this process will immediately have significant implications on reducing the amount I have to pay my accountants, which can then immediately get passed on to my employees. Also, right now, due to the employee shortages we are all facing, the starting wage for an entry level front desk position is $2 more per hour than it was 3 years ago. Convoluted and complex tax laws create more barriers for Wisconsin small business owners, and it's important we remove those barriers to opportunities so we, as Wisconsinites, can improve our own lives.

Thank you for your time and consideration on this flat tax proposal, and I encourage you all as committee members to vote yes and support this piece of legislation.

Sincerely,
Jason Lang, DC

Appleton, WI

To: Members of the Senate Committee on Universities and Revenue

From: Michael Knutson

Date: April 25, 2023

Subject: Support for Senate Bill 1

Chairman Hutton, and members of the Senate Committee on Universities and Revenue, thank you for the opportunity to provide testimony today in favor of Senate Bill 1.

My name is Mike Knutson, I am a husband, father, and one of Wisconsin's many small business owners. I own and operate a lumber yard and hardware store in Cumberland that employs 18.

I, like many, face difficult decisions in both times of prosperity and economic downturns. My employees are the lifeblood of my business and critical members of our community. I compete with online stores, large corporations, and area businesses for not only customers but for talent. Bearing a large tax burden on the company I've worked hard to create only places downward pressure on the wages and benefits I can offer. This makes it difficult to compete for limited labor and with larger companies. My employees are like family and I hope to continue compensating them fairly. I'd look forward to a more favorable tax environment in which I can pass the savings to my staff who would also experience better rates.

Small businesses should not be punished for taking on risk, seeking expansion, or earning success. We support our children's youth leagues, we support our charities and community events, and we employ our neighbors. We are vested in our communities and only seek to make them better for everyone. We bear the stress of employing our friends who count on employment to support their families as we do ours. Tax reform would also allow more competition for labor and bring new businesses or families into our communities.

Thank you for the taking the time to read my testimony. Our state is a wonderful place to live, raise a family, and recreate. We should be competing more effectively with other states for limited labor while facing a period of high inflation and disrupted supply chains. We were lucky to make it out of the pandemic and now we are focused on growing what we have. I hope to see Senate Bill 1 enacted so that I can continue to make our community more prosperous and continue to run a successful small business in Cumberland.

Michael Knutson

To: Members of the Senate Committee on Universities and Revenue

From: Ryan Furchenicht

Date: April 25, 2023

Subject: Support for Senate Bill 1

Chairman Hutton, and members of the Senate Committee on Universities and Revenue, thank you for the opportunity to share my support in favor of Senate Bill 1. My name is Ryan Furchenicht. I am the owner of a concrete company in northern Wisconsin.

I normally do not get involved in legislative issues but felt compelled to write in favor of a flat tax reform in Wisconsin. I have two children, a wife, and have seven employees. The pandemic and material sourcing for concrete placed significant strain on my small business and family. You all have a great opportunity to fundamentally change our state for the better.

The concrete industry is expensive. Our material prices are up, the machines cost more, and finding help is a challenge. A shift in our income tax would allow small businesses like mine more flexibility in competing for employees, improving the compensation for our current staff, and to keep growing our company. We live in a small town and serve small communities. We are involved in our kids' activities and sports, our community's events, and we hope to keep it that way. There is a misconception that a tax cut like this would just mean more money concentrated in few hands. Where I am from, that couldn't be further from the truth. Not only could I expand, hire, and increase compensation, but our business and family's money stays in our community. It is the best stimulus one could provide. We face difficult decisions at times but a change like this would allow us to invest more in our neighbors and community.

I thank you for your time and hope you seriously consider approve Senate Bill 1. This is a great opportunity to make our state more competitive and to allow small businesses like mine to flourish. This change would be a great one for my company and family but also my employees and community.

Testimony in support of SB1 by Steven Janke Founder/CEO of Mission Wisconsin

As a veteran small business owner in the great state of Wisconsin, I believe that implementing a flat tax system would be a powerful tool to attract and retain talented individuals to our state. My business is in the business of Talent Attraction, attending Hiring Events on Military Bases around the world to share the gospel of the great state of Wisconsin and to help those military families connect to everything our state has to offer, reducing and simplifying the tax system would be a key factor for those considering relocating or returning to the great state of Wisconsin.

The current tax system is a significant disincentive for talented individuals to move to Wisconsin or stay in our state. The complex and confusing tax code can create significant uncertainty for individuals, making it difficult for them to plan their finances and invest in their future.

A flat tax system would simplify the tax code and provide greater certainty and predictability for individuals, making it easier for them to plan their finances and invest in their careers. This predictability would help to attract and retain talented individuals in Wisconsin, who are essential to the growth and prosperity of our state.

Moreover, a flat tax system would promote fairness and equality, treating all individuals and businesses equally under the law. This would help to create a level playing field for all individuals, regardless of their income level, and encourage greater social mobility and economic growth in our state.

By attracting and retaining talented individuals, a flat tax system would help to create a more vibrant and dynamic economy in Wisconsin, generating new opportunities and increasing prosperity for all residents of our state.

In conclusion, as a veteran small business owner in Wisconsin, I strongly support the implementation of a flat tax system. By simplifying the tax code, promoting fairness and equality, and helping to attract and retain talented individuals, a flat tax system would provide significant benefits to businesses and individuals in our state, helping to ensure a prosperous and vibrant future for Wisconsin.

NATIONAL TAXPAYERS UNION

Date: April 25, 2023
To: Members of the Wisconsin Senate Universities and Revenue Committee
From: Mattias Gugel, Director of State External Affairs at National Taxpayers Union
Re: Support Senate Bills 1 & 2

Businesses and taxpayers continue to reel from the aftermath of the pandemic and the effects of inflation. As a result, Wisconsin must pursue efforts to keep up with the reforms of other Midwestern states to maintain its reputation as a business-friendly state and keep family-supporting jobs for Wisconsin workers and families.

As the nation's oldest taxpayer advocacy group, National Taxpayers Union is encouraged to see Wisconsin — at a time when it has a historic $7 billion surplus — prioritizing tax relief. Now is not the time to increase government spending or consider increasing local government levy limits to undo the excellent work being done by the state.

Senate Bill 1 — Moving Wisconsin toward a 3.25% flat tax
Competition between states has become increasingly common, and in recent years we have seen migration patterns of people moving away from high-tax states toward states with low or no income tax. This bill will make Wisconsin competitive going into the next decade with a rate that competes with the single tax rates in Michigan, Indiana, and Illinois — and the new flat tax rates we'll soon see in Iowa.

Notably, all Wisconsin taxpayers would win under this tax proposal. Every tax bracket sees a cut, which will help families who are struggling right now and help Wisconsin retain and attract workers who are so desperately needed.

Senate Bill 2 — Repeal of the personal property tax
Wisconsin's current personal property tax has been the target of reform for several past sessions. Unfortunately, these efforts have created a patchwork of carve-outs determining who needs to comply with reporting this owed tax, depending on which industries have been most successful lobbying. As a voice for all taxpayers, National Taxpayers Union is encouraged that there may be the opportunity to pass a meaningful bipartisan repeal of this costly tax on the property of business owners.

Furthermore, SB 2 would help streamline tax collection and alleviate the red tape on business owners for assessment while ensuring the state doesn't leave local governments with a budgetary hole.

NTU would like to commend the bill authors of the flat tax bill, Senate Majority Leader Devin LeMahieu and Representative Robert Brooks, the authors of the repeal of personal property tax, Senator Duey Stroebel and Representative Dan Knodl, and Senate Universities & Revenue Committee Chairman Rob Hutton for their pursuit of making Wisconsin friendlier to taxpayers. We hope their important work is successful.

WMC

Wisconsin's Chamber

TO: Senate Committee on Universities & Revenue

FROM: Evan Umpir, Director of Tax, Transportation, and Legal Affairs

DATE: April 25, 2023

RE: Testimony on Senate Bill 1, Establishing a Flat 3.25% Individual Income Tax Rate

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Thank you Chairman Hutton, Ranking Member Larson, and Committee members for the opportunity to testify in support of 2023 Senate Bill (SB) 1, which would establish a fat 3.25% individual income tax rate in Wisconsin. WMC would like to thank Senator LeMahieu and Representative Brooks for authoring this proposal, as well as, all legislators who have over the last dozen years enacted pro-growth policies which have created the conditions for conversations on policies like SB 1 to occur today.

WMC is the largest general business association in Wisconsin, representing approximately 3,800 member companies of all sizes, from every sector of the economy. Since 1911, our mission has been to make Wisconsin the most competitive state in the nation to do business. A tax structure that fosters hard-work and growth, for both individuals and businesses, is one of the most, if not the most, important public policies a government can set – it lays the groundwork for success and prosperity or can leave workers and businesses struggling to get by. Our state motto, "Forward," urges us, as individuals and as a state, to strive for success; **our state government should enact policies that allow individuals and businesses to have the best chance for success and reward hard work.**

Wisconsin's business climate ranks 27th in the nation, down from our peak at 25th in 2020 after years of consistent progress.[1] **Wisconsin peaked at middle of the pack, and now is going in the wrong direction – backward.** While this is just one measure of Wisconsin's health as a state, it is a vitally important one. Businesses are an essential component to everyday life. Businesses provide jobs that help support our families, they sell essential goods and services and quench our need for recreation and relaxation, and more importantly, they *produce* goods and provide services we most likely would not have on our own– simply put, business is the silent engine vital to our every-day lives and health of our economy.

In WMC's Winter 2023 Employer Survey we asked, "What is the one thing state government could do to improve Wisconsin's business climate?" **Wisconsin employers said "reduce taxes" was the <u>one thing</u>** state government could do **to improve our business climate** – by a *2:1 margin* over the next closest policy action. Eighty-nine percent of respondents support "significantly reducing and flattening the state individual income tax." By contrast, only four percent opposed

[1] Janelle Fritts and Jared Walczak, "2023 State Business Tax Climate Index," Tax Foundation (October 25, 2022), available at: https://taxfoundation.org/2023-state-business-tax-climate-index/.

the statement.

A 3.25% flat tax will make Wisconsin a more competitive state to conduct business, attract and retain workers to fill open jobs, and boost our economy.

Instituting A 3.25% Flat Tax Will Make Wisconsin More Competitive

Wisconsin cannot afford to do nothing about our tax climate; doing nothing is falling behind. Fifteen years ago Utah adopted a 5% flat tax, but more recently, Arizona moved to a 2.5% flat rate and Colorado a 4.4% rate; this left the president of the Utah Taxpayer Association saying, "We're no longer the cool kid on the block at all."[2]

"Forty-three states adopted tax relief in 2021 or 2022—often in both years—and of those, 21 cut state income tax rates."[3] This year, 27 states are considering some form of tax relief or cuts.[4] **Wisconsin's top rate (7.65%) is currently *8th highest* in the nation.** This is significant because approximately 90% of Wisconsin businesses are pass-through entities paying this high rate.

Wisconsin must compete against 43 states that have a lower rate or no income tax at all. Nine states have no income tax (Alaska, Florida, Nevada, New Hampshire,[5] South Dakota, Tennessee, Texas, Washington, and Wyoming); another **13 states have a flat rate or are moving toward one currently** (Arizona, Colorado, Georgia, Iowa, Idaho, Illinois, Indiana, Kentucky, Michigan, Mississippi, North Carolina, Pennsylvania, and Utah). Instituting a 3.25% flat tax would have Wisconsin join our Midwest neighbors of **Iowa, Illinois, Michigan, and Indiana, which *all have a flat income tax rate* with rates *all lower* than Wisconsin's top 7.65% bracket.**[6]

Adopting SB 1's flat 3.25% rate would catapult us toward the top of the list moving Wisconsin from 8th *highest* top rate to the *6th lowest rate overall*, instantly making Wisconsin more competitive both nationally and in the Midwest. **A 3.25% rate would have us sit only slightly behind our competitors Indiana (3.15%) and Pennsylvania (3.07%) and ahead of Iowa (3.9%), Ohio (top rate 3.99%), and Michigan (4.25%).** It should be noted a proposal has been introduced in Ohio that would institute a 2.75% flat tax[7] which would make it the lowest rate in the region and second lowest rate of all states that levy an individual income tax. Indiana, Pennsylvania, Iowa, Ohio, and Michigan are *Wisconsin's direct geographic and manufacturing*

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[2] Editorial Board, "The State Tax-Cut Movement," The Wall Street Journal (February 3, 2023), available at: https://www.wsj.com/articles/the-state-tax-cut-movement-budget-revenue-flat-tax-11675120292.
[3] Jared Walczak, "There's Still Room for Responsible State income Tax Relief in 2023," Tax Foundation (February 1, 2023), available at: https://taxfoundation.org/state-income-tax-relief-2023/.
[4] Selena Fragassi, "Tax Cuts: 50% of States Are Pushing For Reductions or Eliminating Taxes Altogether," GoBankingRates (April 1, 2023), available at: https://www.gobankingrates.com/taxes/tax-laws/tax-cuts-states-pushing-reductions-eliminating-taxes-altogether/.
[5] New Hampshire taxes *only* investment income at 4%, which will be phased out at the end of 2026.
[6] Iowa is moving towards a 3.9% flat rate by 2026; Illinois has a 4.95% flat rate; Indiana has a 3.15% rate which will further drop to 2.9% if measurements are met; and Michigan has a 4.25% rate, 4.05% in 2023 (the permanence of this rate reduction is disputed).
[7] *See* Ohio H. B. No. 1, available at: https://ohiohouse.gov/legislation/135/hb1.

competitors and should therefore be used to calibrate our efforts in the race to compete for attracting workers and businesses.

Wisconsin *must* position itself as the most competitive it can be, both in the Midwest and nationally. Adopting SB 1 is a prudent policy option that will make us one of the "cool kid[s] on the block" while significantly improving our business and economic climate.

A 3.25% Flat Tax Will Make Wisconsin More Attractive to Workers

Wisconsin is not immune to the workforce shortage plaguing the country. WMC's Winter 2023 Employer Survey found 85% of our members are having trouble hiring employees. According to the Job Center of Wisconsin, nearly 100,000 jobs are available in the state but just over 33,000 resumes are on file, all while there was a 2.5% unemployment rate in March 2023. If every jobseeker on file with the Job Center of Wisconsin was matched and hired by an employer, roughly two-thirds of job openings would remain vacant. The workforce shortage is not *just* a demographic or migration issue (or a weather issue either), the workforce shortage is also an *opportunity issue*.

Data show that workers can and will seek work where they have the opportunity to keep more of the money they earn by moving to low- and no-tax states. In 2022, the states that saw the most population growth were low-tax states. **From 2013 to 2020, four people moved into low-tax states for every one person that moves out.[8] Meanwhile, two and a half people leave high-tax states for every one person who moves in.[9]** Low- and no-tax policies spark a virtuous cycle that allow businesses to reinvest in themselves and their workers, workers see the prosperity occurring in these low- and no-tax states, and more workers and businesses are drawn to the economic activity.

SB 1's proposed 3.25% flat rate will spark this virtuous economic cycle in Wisconsin and draw workers, and businesses, to the opportunity beacon of low taxes. **"In the top third of states for population growth (including D.C.), the average combined top marginal state income tax rate is about 4.0 percent. In the bottom third, it's about 6.6 percent."[10]** Wisconsin's current top three rates are well above the 4.0%. As other states have, or move to, flat and lower tax rates, Wisconsin is quickly falling behind and becoming less attractive to workers because of our poor income tax climate. California, which has one of the *best weather climates* in the country, also has *one of the worst tax climates*, and was one of the biggest losers in 2020; **states that lost the most income generally had high income and property taxes, a migration trend that has accelerated since the federal cap on the SALT deduction took effect.[11]** Low taxes don't just

[8] Dana Andeson, "For Low-Tax States, Four People Move In For Every One Person Who Leaves," Redfin (May 18, 2021), *available at*: https://www.redfin.com/news/low-tax-states-migration/.
[9] *Id.*
[10] Janelle Fritts, "Americans Moved to Low-Tax States in 2022," Tax Foundation (January 10, 2023), available at: https://taxfoundation.org/state-population-change-2022/.
[11] Editorial Board, "The Great Pandemic Wealth Migration," The Wall Street Journal (June 3, 2022), available at: https://www.wsj.com/articles/irs-taxes-low-high-state-migration-moving-pandemic-remote-work-cost-of-living-11654289927.

attract workers and businesses, sparking a virtuous cycle of prosperity, but *high taxes appear to actively drive people away*. Wisconsin needs to be attracting and retaining talent by every means possible to address the workforce shortage.

A lower tax rate *will* attract workers and fill Wisconsin jobs. A recent study examining adoption of a flat tax at a rate *higher than 3.25%* would produce nearly 25,000 jobs over five years.[12] **A 3.25% flat tax would make Wisconsin one of the most competitive states that levy income taxes and is bound to lure workers from states with a rates higher than Wisconsin's flat rate.** By contrast, studies examining *elimination* of Wisconsin's income tax would produce even greater projected job growth (more than 160,000 jobs created) than the study examining a higher rate.[13] As noted, a 3.25% flat rate would make Wisconsin's the 6th most competitive tax rate, is not as aggressive as complete elimination, but sets the state up for needed job growth while providing a meaningful tax reduction for individuals and businesses alike.

<u>The 3.25% Flat Tax Will Boost the Economy and Benefit Both Individuals & Businesses</u>

Most importantly, the direct impact a 3.25% flat tax rate would have is ensuring that workers and businesses are able to keep more of their hard-earned dollars. This money can and will be used to reinvest in workers and business operations and spend at Wisconsin businesses, creating a virtuous cycle that is good for the Wisconsin economy, businesses, and state coffers through the sales and income taxes that will be paid as a result of these tax savings and consumption.

A 3.25% rate will result in real-world savings for every Wisconsinite. **After-tax household income is projected to increase by 5.27%.**[14] Another projection calculates between 2023 and 2026 **the cumulative average tax decrease is more than $4,400 and annually $1,799 thereafter.**[15] As a result of these savings, household spending is expected to increase by 4.4%.[16] This cash-infusion for families will be similarly felt by businesses.

As a result of savings from a rate cut to 3.25%, **gross state product is projected to increase by $13.7 billion (4.5%)** as pass-through businesses reinvest in their businesses.[17] This increase is reaffirmed by studies and data on the effect tax rates and cuts on state gross product. **"Gross state**

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[12] Donald Bruce, "The Economic Implications of a Flat-Rate Income Tax for Wisconsin," Badger Institute (April 18, 2023), available at: https://www.badgerinstitute.org/wp-content/uploads/2023/04/2023_PolicyBrief-FLAT-RATE-TAX.pdf.
[13] Noah Williams, "Fundamental State Tax Reform: Eliminating the Income Tax in Wisconsin," Center for Research on the Wisconsin Economy (December 16, 2021), available at: https://crowe.wisc.edu/wp-content/uploads/sites/313/2021/12/Fundamental-State-Tax-Reform.pdf.
[14] Junjie Guo, Kim Ruhl, and Ananth Seshadri, "Economic Impact of Lowering Income Tax Rates in Wisconsin," Center for Research on the Wisconsin Economy (February 24, 2023), available at: https://crowe.wisc.edu/wp-content/uploads/sites/313/2023/02/WisconsinIncomeTaxReform.pdf.
[15] Dan Spika, Memo to Sen. Devin LeMahieu on LRB 1049/1, Legislative Fiscal Bureau (January 12, 2023).
[16] Guo et al., "Economic Impact of Lowering Income Tax Rates in Wisconsin."
[17] Guo et al., "Economic Impact of Lowering Income Tax Rates in Wisconsin."

product grew 56 percent faster in states without an income tax than it did in those with one over [the past decade]," based on U.S. Bureau of Economic Research statistics as noted in a Tax Foundation report analyzing West Virginia's income tax elimination proposals.[18] A 2021 study by Nguyen, Onnis, and Rossi found:

> If the average income tax rate were cut by 1 percentage point, GDP in the immediate aftermath (within one quarter) of the tax change would increase by 0.78 percent. Four quarters after the income tax cut, GDP increased by 1.5 percent. . . . **On average, the maximum effect of tax cuts was realized by the fourth quarter, when private investment had increased by 4.6 percent.**[19]

At this time with such a tight labor market, businesses can use tax savings to reinvest in their operations, including worker wages, and all workers will have more in their pocket as a result of these tax cuts. SB 1 can spark the virtuous economic cycle other low- and no-tax states are seeing by adopting a 3.25% flat individual income tax rate.

* * *

> "Research shows that people follow opportunity, but high taxes can serve as a deterrent. As other states take action, Wisconsin cannot rest on its laurels. A bold tax reform plan will help drive the state's economy forward." – WMC Foundation's *Wisconsin 2035* Report

Wisconsin has an opportunity to unlock a renaissance of economic activity while simultaneously addressing our workforce, demographic, and migration challenges by enacting a 3.25% flat tax. Lowering Wisconsin's rate to a flat 3.25% would make us more competitive, attract workers to fill nearly 100,000 open jobs, and allow workers and businesses to keep more of their hard earned money. As states across the country consider tax relief, Wisconsin cannot afford to fall behind. Wisconsin has one of the highest marginal tax rates in the country. If recently re-elected Democrat Governor Jared Polis can make progress toward his goal of *eliminating* Colorado's individual income tax[20] and remain the "cool kid on the block," surely Wisconsin can charge "Forward" and unlock the prosperity and opportunity a 3.25% flat rate can offer.

Thank you for your time and consideration of SB 1.

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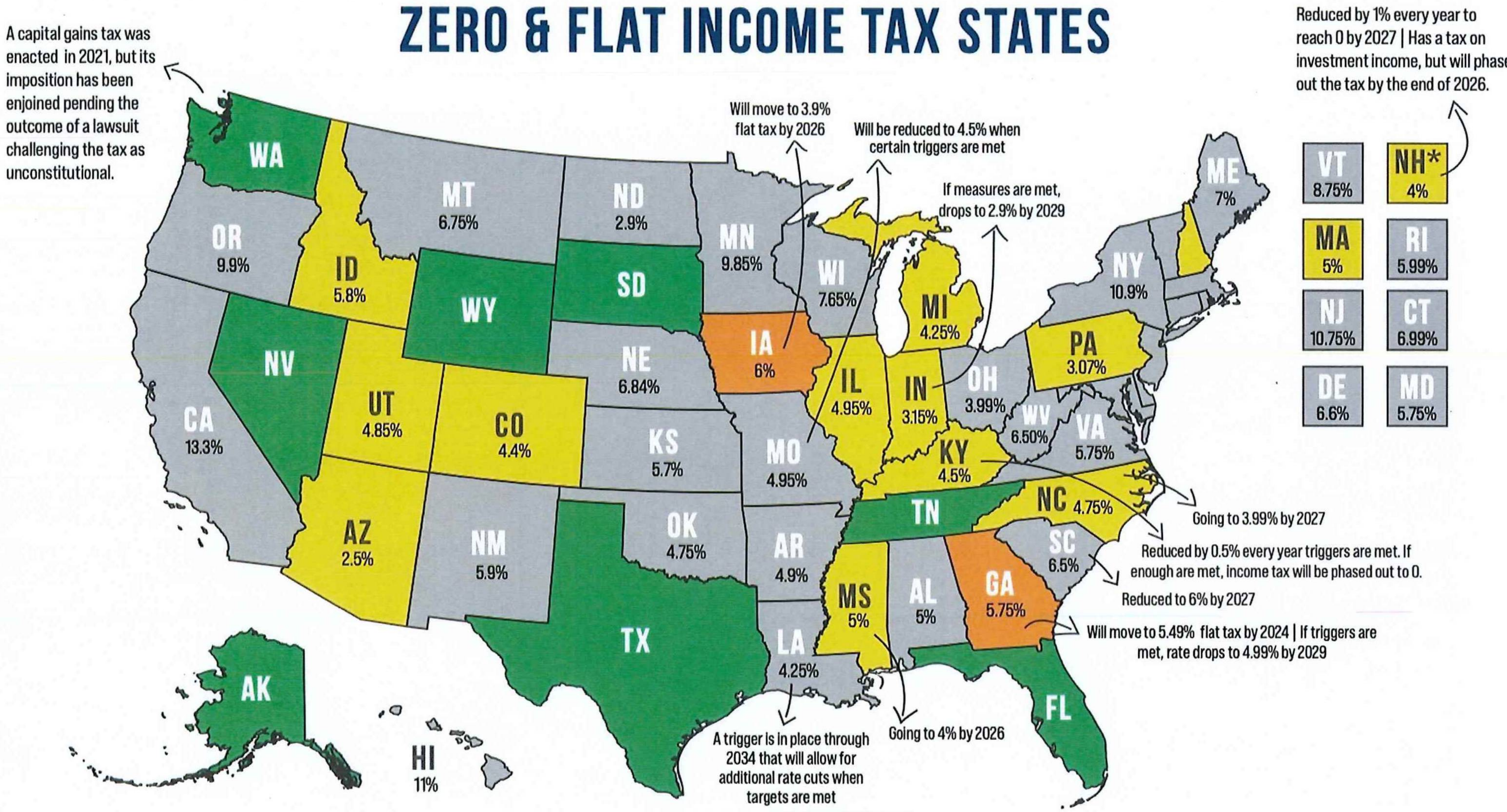
[18] Jared Walczak, "Evaluating West Virginia Income Tax Repeal Plans," Tax Foundation (March 30, 2021), available at: https://taxfoundation.org/west-virginia-income-tax-repeal/.
[19] Timothy Vermeer, "The Impact of Individual Income Tax Changes on Economic Growth," Tax Foundation (June 14, 2022), available at: https://taxfoundation.org/income-taxes-affect-economy/.
[20] Ben Murrey, "Colorado on Track to Eliminate Its Income Tax," National Review (February 7, 2023), available at: https://www.nationalreview.com/2023/02/colorado-on-track-to-eliminate-its-income-tax/ ("I don't expect that we can fully eliminate the income tax by our 150th anniversary [in 2026], but let's continue to make progress.").

AMERICANS *for* TAX REFORM

ZERO & FLAT INCOME TAX STATES



STATES WITH ZERO INCOME TAX | STATES WITH A FLAT INCOME TAX | STATES THAT PASSED LEGISLATION TO MOVE TO A FLAT INCOME TAX | STATES WITH GRADUATED INCOME TAXES

NOTE: PERCENTAGES REFLECT THE TOP MARGINAL STATE INDIVIDUAL INCOME TAX RATES AS OF JANUARY 1, 2022.

MEMO

TO: Senate Committee on Universities and Revenue

FROM: Chris Reader, IRG Action Fund Executive Vice President
Alex Ignatowski, IRG Action Fund Director of State Budget and Government Reform

DATE: April 25, 2023

RE: Testimony in support of SB 1, bold income tax reform

Chairman Hutton and members of the committee,

Thank you for holding this hearing today. Senator LeMahieu, thank you for authoring this important legislation. My name is Chris Reader. I'm the Executive Vice President of IRG Action Fund, the 501(c)4 advocacy partner of the Institute for Reforming Government. With me is Alex Ignatowski, our Director of State Budget and Government Reform.

With tax day having just passed us in Wisconsin, this bill is very timely. Taxpayers are frustrated that they have to pay so much to the state government, especially when government spending seems unchecked, is higher per capita than many other states including all of our neighbors, and at a time when the state has a $7 billion dollar surplus. Middle class families are also feeling the pinch as inflation woes continue, and a recession seems just around the corner. When the Institute for Reforming Government's community engagement team traveled the state last year, traveling over 5,000 miles and meeting with hundreds of people, high income taxes came up as a problem in need of addressing regardless of zip code or industry. From farmers to entrepreneurs, high taxes were continually discussed as an anchor on the state's economy.

The status quo is unacceptable. You have an opportunity before you to rework the state's tax framework and help middle class workers bring home bigger paychecks while injecting a boost into the economy. It's time to make Wisconsin the best state in the midwest and competitive nationally when it comes to our income tax. Senate Bill 1 would do just that by ushering in a new era of bold tax policy in the Badger state. It would put Wisconsin on the map for investors, workers, and employers.

When you support SB 1, you'll have the support of the voters. When voters were asked about the topic of taxation back in December, nearly six-in-ten Wisconsin voters said state taxes are too high. When asked specifically about eliminating the state personal income tax, voters were very open - with a plurality of 45% already in support. Voters support bold tax reform because they understand that if you're not growing, you're losing out. And Wisconsin is currently losing out. We're losing retirees to states that don't tax retirement income. We're losing entrepreneurs and capital investment to states with more favorable tax structures. We're losing families and workers to states with more job opportunities, and to states that let them keep more of their paycheck each week.

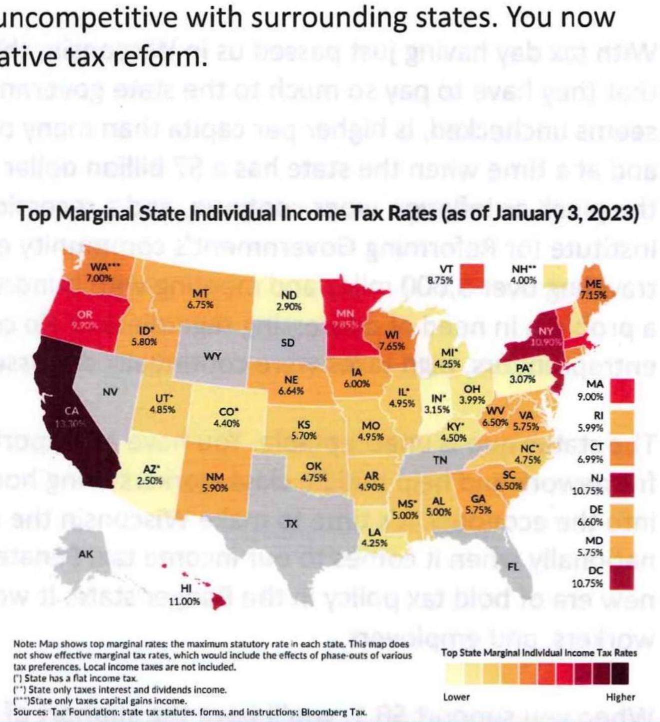
Employers all over Wisconsin are still struggling to find enough workers - from manufacturing to healthcare, education to retail - Wisconsinites are looking to you to help turn the fortunes of our state around.

Looking at migration patterns and it is clear - people continue leaving high income tax states in favor of low tax and even no tax states. That's why Iowa, Mississippi, Arkansas, even the Democratic Governor of Colorado, are looking to flatten and eliminate their income taxes. The battle for workers is real - and right now Wisconsin is not in the game.

—

One of the driving reasons for support of bold tax reform is the current tax climate in Wisconsin. We currently rank 32nd nationally according to the Tax Foundation. We have the second highest top bracket rate in the midwest (second only to Minnesota at 9.85%) and we are one of only two midwest states that do not already have or are not moving towards a flat tax. Even Illinois has a flat tax rate of 4.95%, and when Illinois voters were asked to move to a progressive tax system a few years ago, voters rejected the notion in favor of staying with a flat tax system. Wisconsin's tax policy is outdated, leaving us uncompetitive with surrounding states. You now have the opportunity to enact real, transformative tax reform.

Wisconsin's high tax burden has driven higher levels of spending too. The 1999-2001 state budget spent $44.2 billion over the biennium. The current 2021-2023 budget will spend $89.2 billion. In the space of 20 years we have doubled our spending. If you adjust for inflation, the 1999-2001 budget would equal $79.2 billion in 2023 dollars. This amounts to a 13% increase in spending over the same time period.



When you compare Wisconsin's spending to other midwest states, the picture doesn't look any better. According to the Kaiser Family Foundation, Wisconsin spends more per capita than any of our neighboring states. At $10,067 per capita, we spend almost $1,000 more than Illinois.

We need to change the way Wisconsin taxes and spends if we want to compete with our neighboring states for jobs, workers, and families. Tax reform is a key component to making Wisconsin competitive again.

Rank	State	Spending Per Capita
1	Wisconsin	$10,067
2	Illinois	$9,118
3	Iowa	$8,932
4	Minnesota	$8,413
5	Michigan	$6,807

**Kaiser Family Foundation*

The individual income tax in Wisconsin does not just affect individual taxpayers. It is important to note that 90% of small businesses in Wisconsin pay the individual income tax as a pass-through and that 75% of these businesses are taxed at the highest bracket. When you consider that small businesses in Wisconsin employ half of the workforce in our state, you can start to see the huge impact a flat tax would have on the economy. Right now, you have an opportunity to change our course and set Wisconsin apart from other states. The flat tax takes us in that direction.

—

Wisconsin has a historic opportunity. We have a $7.1 billion surplus. Legislative leaders and Governor Evers have all said that the state should provide meaningful tax relief again this season - the question is how bold are you willing to be? Will you only work around the edges, pick winners and losers, or take bold action and bring a flat tax to Wisconsin? If you want to grow the economy, increase take home pay of all workers, help small businesses invest in new jobs, and even increase revenue to the state, you will support this bill. Studies by CROWE and other economists have shown that the greater the tax reform, the greater the economic benefit for families and businesses. Today you have a once-in-a-generation opportunity to right the direction of our state. The Legislature and Governor should agree to pass transformational tax reform and make our state competitive once again.

To: Members of the Senate Committee on Universities and Revenue

From: Megan Novak, State Director, Americans for Prosperity - Wisconsin

Date: April 25, 2023

Subject: Support for Senate Bill 1

Chairman Hutton, and members of the Senate Committee on Universities and Revenue, thank you for the opportunity to provide testimony today in favor of Senate Bill 1.

On behalf of thousands of Americans for Prosperity – Wisconsin activists across the state, we strongly support Senate Bill 1 to move Wisconsin to a flat income tax. We strongly believe that taxes should be simple, fair, and easy to understand. A flat tax achieves all of these goals, while also helping to jumpstart our economy and small businesses.

Wisconsin businesses are the backbone to our economy, and many small businesses in our state file under the personal income tax code as pass-through entities. Thousands of these main street businesses are paying a tax rate of 7.65%, an incredibly high tax burden that stifles economic growth and innovation. Our individual tax rates are uncompetitive at best, and hostile at worst. In fact, only nine states in this country have an income tax rate higher than our 7.65% top rate that so many small businesses pay right now.

Moving Wisconsin to a 3.25% flat tax will:

- Allow small businesses to invest in their employees, business expansion, and their communities
- Attract more families to our state with a much more competitive tax rate
- Keep more of our hard-earned money in our pockets, instead of sending it to Madison

The Legislature has the opportunity to transform Wisconsin for the better with Senate Bill 1 for generations to come. Wisconsin's small businesses, families and economy will all be better off with the passage of this needed legislation. Thank you for your consideration and support of Senate Bill 1.

WISCONSIN INSTITUTE FOR LAW & LIBERTY

April 25, 2023

Chairman Hutton and Members of the Senate Committee on Universities and Revenue,

Thank you for the opportunity to testify in favor of Senate Bill 1 today. My name is Kyle Koenen and I am the Policy Director for the Wisconsin Institute for Law & Liberty, a non-profit law and policy center based out of Milwaukee. I want to thank Senator LeMahieu and Representative Brooks for their leadership in bringing this proposal forward to start an important discussion about how we can make Wisconsin more competitive economically.

Wisconsin is in constant competition with states when it comes to attracting businesses and individuals who are looking for places to live, work, and invest. One key factor that can make a state more attractive is a low overall tax burden. High taxes deter businesses from setting up shop in the state and make it less attractive to potential residents. In recent years, many states have recognized that in order to compete they need to lower their overall tax burden. This has spurred a tax revolution of sorts, with nearly half the states acting in 2021 and 2022 to reduce taxes.

To start, it's important to have a snapshot of the tax landscape around the nation today to understand where Wisconsin ranks amongst its peers. The Tax Foundation's most recent 2023 Annual State Business Tax Index ranks Wisconsin 27th in overall tax climate and 38th overall in income tax burden. For comparison, many states have made low taxes a top priority.

- There are currently 7 states that levy no income tax at all.[1]
- There are also 13 states that currently have some form of a flat income tax rate.[2]
- Both Iowa and Georgia recently passed tax reform packages that will phase in a flat tax over several years.[3]

Wisconsin's top marginal tax rate of 7.65% also makes us uncompetitive amongst peers, as only eight states have higher top marginal tax rates. [4] Why does this matter? For Wisconsin businesses, of which 95% are primarily structured as pass-through entities, high individual income tax rates are particularly concerning, as these businesses' profits "pass through" to their owners' individual tax forms. This means that a higher top marginal income tax bracket puts Wisconsin at an economic disadvantage, thus resulting in less money for businesses to reinvest, leading to decreased hiring, capital investment, and economic output.

We live in an age of heightened mobility, where businesses and individuals can operate or work from anywhere, creating a heightened level of competition among states for talent. This competition is supported by data that confirms its existence. For instance, of the 8 states that have higher top marginal tax rates than Wisconsin, six experienced a population decline in 2022.

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[1] No Income Taxes - Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, Wyoming (Tax Foundation)

[2] Flat Income Taxes - Arizona: 2.5%; Colorado: 4.4%; Idaho: 5.8%; Illinois: 4.95%; Indiana: 3.15%; Kentucky: 4.5%; Michigan: 4.25%; Mississippi: 5.0%; New Hampshire: 4% on interest and dividends only; North Carolina: 4.75%; Pennsylvania: 3.07%; Utah: 4.85%; Washington: 7.0% on capital gains income only. (Tax Foundation)

[3] Iowa will move to a 3.9% flat income tax by 2026. Georgia will move to a 4.99% flat rate by 2029.

[4] Highest Top Marginal Tax Rates - California: 13.3%; Hawaii: 11%; New York: 10.9%; New Jersey: 10.75%; Oregon: 9.9%; Minnesota 9.85%; Massachusetts: 9%; Vermont: 8.75%; Wisconsin 7.65% (Tax Foundation)

Moreover, according to a 2022 study by my colleagues at the Wisconsin Institute for Law and Liberty, while Wisconsin experienced a positive net in-migration from "less free" states such as Illinois and Minnesota, it also lost many residents to "freer" states like Florida and Texas.[5]

According to a recent study conducted by the Center for Research on the Wisconsin Economy (CROWE) at UW-Madison, there is evidence that lower income taxes can lead to significant economic growth[6]. The analysis found that if Wisconsin were to adopt a 3.25% flat income tax, it could result in a 4.5% increase in gross state product, equivalent to $13.7 billion. Additionally, such a change could lead to a 4.4% increase in household consumption and a 5.27% increase in after-tax income. That means more money in the pockets of Wisconsin families, particularly during a period of high inflation.

As the state legislature mulls over Senate Bill 1 and the possibility of tax relief in the state budget, it's important to note that despite tax cuts over the past decade, state revenues have continued to grow considerably. While the phase-in approach proposed in this legislation is sensible, incorporating a trigger law, which has been enacted in other states, could be another useful tool for consideration. A trigger law would automatically reduce taxes during periods of high revenue, similar to the state's rainy-day fund. Some states have used tax triggers to link tax reform to revenue availability or to prepare for potential economic downturns. Oftentimes, these safeguards are not needed, and lawmakers may even find themselves fully enacting the tax cuts sooner than expected.

In conclusion, Senate Bill 1 provides an opportunity for Wisconsin to take a significant step towards becoming a more economically competitive state. Lowering the overall tax burden, particularly the top marginal income tax rate, can make the state more attractive to businesses and individuals, leading to increased economic growth and job creation. I urge the committee to support Senate Bill 1 and move forward with this important discussion on how to make Wisconsin more competitive and prosperous for all. Thank you.

Kyle Koenen
Policy Director
Wisconsin Institute for Law & Liberty

[5] Hoffer, A., Style, M., Flanders, W. (2022). *Voting With Their Feet: Economic Freedom and Migration in Wisconsin*. Wisconsin Institute for Law and Liberty. https://will-law.org/voting-with-their-feet-economic-freedom-and-migration-in-wisconsin/

[6] Guo, J., Ruhl, K. Seshadri A. (2023) The Economic Impact of Lowering Income Tax Rates in Wisconsin. Center for Research on the Wisconsin Economy at UW-Madison. https://crowe.wisc.edu/2023/02/24/the-economic-impact-of-lowering-income-tax-rates-in-wisconsin/

WISCONSIN CATHOLIC CONFERENCE

TO: Senator Rob Hutton, Chair
Members, Senate Committee on Universities and Revenue

FROM: David Earleywine, Associate Director

DATE: April 25, 2023

RE: Opposition to SB-1, Establishing a Flat Individual Income Tax Rate

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The Wisconsin Catholic Conference (WCC), the public policy voice of Wisconsin's Catholic bishops, appreciates the opportunity to testify in opposition to Senate Bill 1, which would create a flat individual income tax rate.

This testimony will highlight the Catholic Church's principles and social tradition applied to taxation, and why Wisconsin citizens are not best served by a flat tax.

The Judeo-Christian tradition is the foundation for a variety of secular legal tenets and the basis of Catholic social teaching. The *Compendium of the Social Doctrine of the Catholic Church*, which summarizes this social teaching, has this to say about taxation:

> *Tax revenues and public spending take on crucial economic importance for every civil and political community. The goal to be sought is public financing that is itself capable of becoming an instrument of development and solidarity.* Just, efficient and effective public financing will have very positive effects on the economy, because it will encourage employment growth and sustain business and non-profit activities and help to increase the credibility of the State as the guarantor of systems of social insurance and protection that are designed above all to protect the weakest members of society.
>
> Public spending is directed to the common good when certain fundamental principles are observed: the payment of taxes [739] as part of the duty of solidarity; a reasonable and fair application of taxes;[740] precision and integrity in administering and distributing public resources.[741] In the redistribution of resources, public spending must observe the principles of solidarity, equality and making use of talents. It must also pay greater attention to families, designating an adequate amount of resources for this purpose.[742][1]

By all these measures, the flat tax does not best serve the people of Wisconsin. The tax is by definition regressive and therefore neither just nor equitable. It will not foster social cohesion nor uphold the dignity of the most vulnerable.

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[1] Pontifical Council for Justice and Peace, Compendium of the Social Doctrine of the Catholic Church, 355 (2006).

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In fact, it will dramatically reduce Wisconsin's revenues. According to the Legislative Fiscal Bureau (LFB), in fiscal year 2021-22, individual income tax collections totaled $9.21 billion and comprised nearly 45% of state general fund tax revenue."[2] This revenue is used to fund K-12 education, the UW System, the Department of Corrections, Medicaid, local governments, and other social programs. The LFB estimates that the proposed flat tax would "reduce state general fund tax revenues by: (a) $2,113.5 million in 2023-24; (b) $2,845.1 million in 2024-25; (c) $4,314.7 million in 2025-26; and (d) $5,059.0 million in 2026-27 and annually thereafter."[3] In effect, by 2026, Wisconsin would collect less than half of the income tax it collected in fiscal year 2021-22.

To make up for this revenue loss, the State would have several options. It could increase sales and property taxes, both of which are regressive because taxpayers with low to middle incomes would pay a disproportionate share of the tax burden. The state could choose to drastically cut funding for some, or all, of the programs listed above. Or it could choose a combination of funding cuts or other non-income tax reforms.

In all three scenarios, those in poverty and those in need of assistance will likely see their situation worsen.

Some will argue that private charity can and must do more to assist those in need. The Catholic Church is the largest private charity in the United States. But private charity cannot substitute for what only the public sector can do through the just collection and distribution of tax monies. Private charity cannot substitute for the State's responsibility to assist the most poor and vulnerable. Simply put, taxes are the price we pay to live in a civilized society.

In closing, here are some questions for legislators to consider when formulating tax policies:

1) How is the proposed tax more "just, efficient, and effective" for all Wisconsin's residents than the current system?

2) How will the state of Wisconsin continue to be the "guarantor of systems of social insurance and protection that are designed above all to protect the weakest members of society" if tax revenue declines?

3) How will the proposed tax strengthen "solidarity, equality and making use of talents" for all Wisconsin's residents?

4) How will the proposed tax assist the formation and maintenance of families?

Again, thank you for the opportunity to testify and we respectfully urge you to oppose this bill.

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[2] Legislative Fiscal Bureau, *Informational Paper #2: Individual Income Tax* (January 2023) https://docs.legis.wisconsin.gov/misc/lfb/informational_papers/january_2023/0002_individual_income_tax_informational_paper_2.pdf

[3] Legislative Fiscal Bureau, *LRB 1049/1: Individual Income Tax Four-Year Phase-In of 3.25% Tax Rate* (January 12, 2023) https://www.wheelerbilltracking.com/upload/files/frontpage/doc_122770752063c1846c9d9456.70204616.pdf

Good morning everyone,

My name is Thomas Rocque and I am the owner of Rocque Ridge Guides & Outfitters LLC in Holcombe, WI. Like many generations of veteran entrepreneurs before me I served in the United States Army, as an infantryman and sniper before deciding that I would prefer to be my own boss and was able to start a business that combined the things I was good at with the things and places that I love, outdoorsmanship in Northern Wisconsin.

I am here today to voice my support in favor of Senate Bill 1. A Low Flat Tax Would benefit not only my business but all businesses in Wisconsin. A flat tax system is much simpler, reducing the administrative burden on small startups. It's a more ethical system of taxation that doesn't allow for the picking of winners and losers, while larger and more politically connected companies always seem to get the best deal. It would create more incentives for employees, who suffer this high state tax burden as well. How many times have we heard someone say that it's just not worth it to take that overtime shift because they're not going to see that money anyway. A flat tax system would incentivize hard work and grow the economy by bringing an increase to the work force, help create more small business startups, and free up needed capital for business owners to investment in growing their business. Most importantly, a flat tax would allow the government to put their focus elsewhere, maybe on things like education and student safety, the drug crisis, conservation, healthcare etc.

Furthermore, I am here today to voice my support in favor of Senate Bill 2 The repeal of the personal property tax. This additional compliance and monetary burden on business owners takes money away from them for the property they have purchase to produce goods and services. Money that could be used for the hiring of employees, taxes and benefits for those employees, a greater investment into the growth of their business and their communities, and so much more. For those that don't know in the state of WI to pay an employee $2000 per month costs the business owner paying that salary $2,800. In my shop I am the owner, the operator, the accountant, the door greater, the janitor, and everything in between. Last year I wanted to hire help with some bookkeeping, but quickly found out I just couldn't afford to do that yet. However, with every dime I make and get to keep for reinvestment, I get closer to being able to hire someone from my community and make a difference in their life. Each of these bills that we are discussing here today would lift a regressive financial burden from tens of thousands of small businesses just like mine and stimulate the economy as a result. In my town, my store is the largest and one of the only retail locations. My store is a part of my community and barriers to hiring employees or expanding to offer more isn't just a burden on myself or my business, it is a burden on my whole community.

Thank you.

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111 EAST KILBOURN AVENUE, 19TH FLOOR
MILWAUKEE, WI 53202-6622

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MEISSNER TIERNEY
FISHER & NICHOLS S.C.

THOMAS J. NICHOLS
ATTORNEY AT LAW
TJN@MTFN.COM

April 25, 2023

Members of the Senate Committee on Universities and Revenue
Senator Hutton, Chair
Senator James, Vice Chair
Senator Larson, Ranking Member

Re: Senate Bill 1 – Business Entities

Dear Chair, Vice Chair, Ranking Member and Committee Members:

First, let me say thank you to all of you for holding this hearing. As I am sure you all appreciate, tax policy is a critical matter for all Wisconsin residents. It is especially critical for owners and employees, as well as customers, of Wisconsin's passthrough businesses (S corporations, partnerships and sole proprietorships). It should be a matter of bipartisan concern for all of us.

As indicated in the attached curriculum vitae, I am a member of the Board of Directors of the Taxation Section of the State Bar of Wisconsin, and a long-term member and past chair of the Wisconsin Taxation Committee of the Wisconsin Institute of Certified Public Accountants. I am also a long-term member of the Committee on S corporations of the ABA's Tax Section, as well as a member of the Board of Directors and head of the Board of Advisors for the S Corporation Association, which advocates for Pass-through businesses at the national level. However, to be clear, the views that I am expressing in this written and oral testimony are my own, and are not the formal positions of any of those entities.

I should begin by saying that I am not in a position to strongly advocate for any particular tax rate or set of income tax rates. I'm here to express my view that, for the good of Wisconsin residents, both owners and employees, lawmakers should seriously consider adjusting the income tax rates, including the top income tax rate, for the good of all Wisconsin residents, as explained in more detail in the rest of my testimony.

I realize that arriving at a fair and effective rate structure for Wisconsin requires very difficult balancing and value judgments regarding the needs of the state, as well as discretionary expenditures that may not be absolutely essential, but may be appropriate, given the values and judgments of the electorate. All such determinations also involve unavoidably imperfect predictions regarding performance of the state's and nation's economy, as well as the needs and wants of Wisconsin residents in an uncertain future.

Having said all that, I do think there are certain things that are fairly obvious and should be taken into consideration. First, it is important to recognize the importance of the pass-through business community, both in the nation, and especially in Wisconsin. Attached to my written testimony is a graph that shows that S corporations have grown to constitute well over 70% of all corporations within the nation, and that S corporations and partnerships represent roughly 85% of the business entities in the nation. When you add in sole proprietorships, the percentage of pass-through businesses is well into the 90%'s. Nationwide, pass-through businesses employ almost 2/3 of the working men and women in the United States.

These statistics are even more striking for the state of Wisconsin. As the next graphic in my written materials highlights, privately held companies (the vast majority of which are pass-through businesses, as shown in the preceding graphics) dominate Wisconsin businesses and employment. In fact, 82.7% of Wisconsin's employees work for privately-held employers, placing Wisconsin in the upper 3rd of privately-held employment concentration. It is obviously important for Wisconsin to get the taxation of privately-held pass-through businesses right.

Another unavoidable consideration is the fact that Wisconsin is in competition with all 49 of the other states in trying to attract and retain such businesses. Also attached to my written testimony is a map showing the top income tax rates for the various states. Note that the top marginal rates in southeastern United States hover around 5%, and of course Texas and Florida don't even have an income tax. Wisconsin's top individual income tax rate is 7.65%, which is higher than all of the states outside of the East Coast and West Coast, other than significantly Minnesota (top rate 9.85%) and Iowa (top rate 8.53%). It is important to note that it is this rate that successful entrepreneurs will focus on in deciding the state in which to locate, because it will directly affect the amount of pretax profits they will be able to retain and/or reinvest in the business.

The last graphic is a map showing relative in-migration and out-migration in the various states. Note that, with the exceptions of Louisiana and Mississippi, the southeastern states significantly outperformed the upper Midwest and Wisconsin (+.2%), ranging up to +1.2% (Tennessee and Georgia), +1.3% (North Carolina), +1.6% (Texas), +1.7% (South Carolina) and +1.9% (Florida). Note also that Wisconsin did outperform the two neighboring states with the higher top marginal tax rates, Minnesota (+.1%) and Iowa (+.1%). Of course, there are many factors that go into these demographic trends, but Wisconsin certainly doesn't need to have another factor disadvantaging ourselves in the relative comparison.

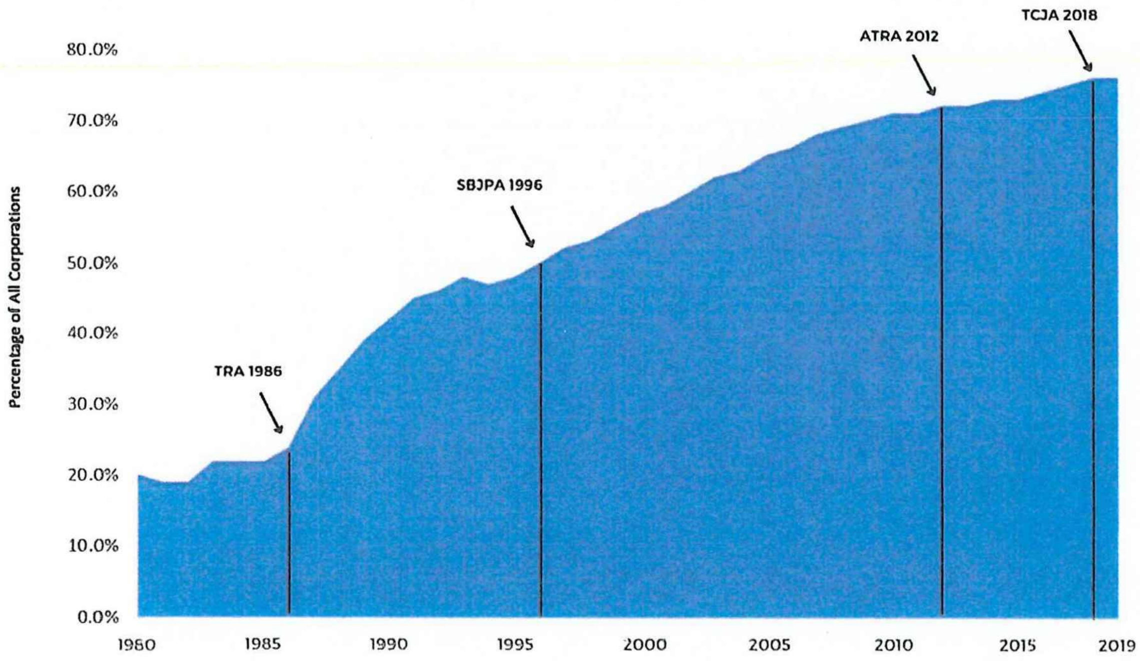
I understand that we are all also properly concerned with relative fairness in tax rates among our citizens. However, I think we can all agree that such fairness should not be achieved at the cost of sacrificing the economic well-being of the state as a whole. Maintaining a relatively high top tax rate doesn't benefit rank and file employees living in Wisconsin if it causes entrepreneurs to leave the state, or not to consider the state as the site for their business in the first place. The same can be said for retired individuals.

Once again, a sincere thank you to the Committee for your attention.

Sincerely,

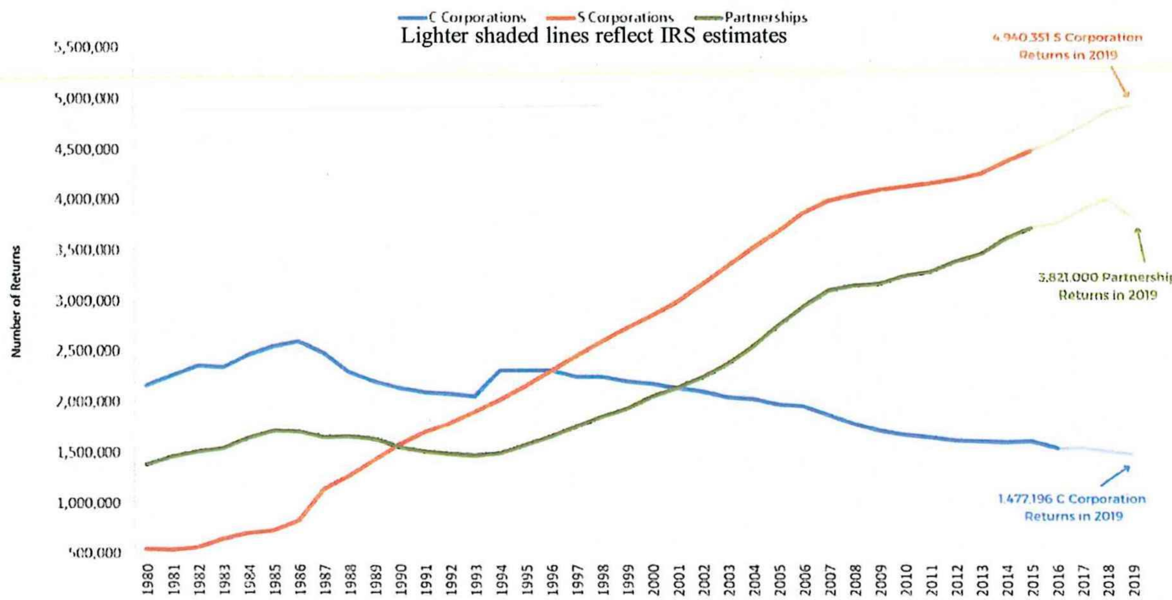
Thomas J. Nichols

Growth of S Corporations



Source: Internal Revenue Service Tax Statistics

Comparison of Business Entities



Source: Internal Revenue Service Tax Statistics

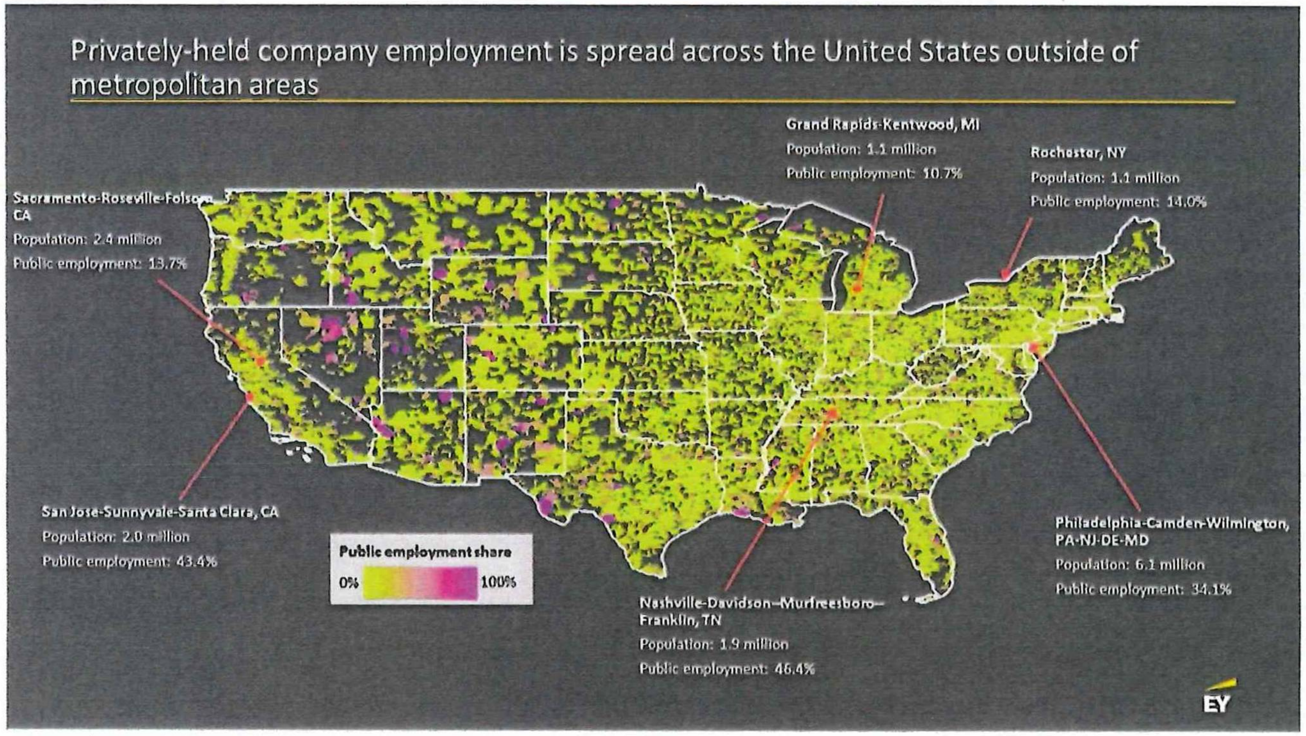
Pass-Through Entity Employment

		Employment & Owners		Employment Percentage	
C Corporations			52,907,321		37.7%
	S Corporations	38,533,460		27.4%	
	Partnerships*	18,131,976		12.9%	
	Sole Proprietorships	30,879,231		22.0%	
Pass-Through Entities			87,544,667		62.3%
Grand Total			140,451,988		100.0%

* Partnerships include general partnerships, limited partnerships, and limited liability companies

Source: US Census Bureau -- County Business Patterns; Internal Revenue Service; Ernst & Young analysis (current as of 2018)

Privately-Held Entities #1



Source: Tax Foundation

Privately-Held Entities #2

Appendix – States ranked by privately-held company employment share

	Total employment (millions)	Public company employment (millions)	Private company employment (millions)	Private company employment share
Maine	0.51	0.06	0.45	87.6%
Hawaii	0.52	0.07	0.45	86.8%
North Dakota	0.34	0.05	0.29	86.4%
Wyoming	0.20	0.03	0.17	85.7%
Montana	0.36	0.05	0.31	85.5%
District of Columbia	0.53	0.08	0.46	85.4%
Nebraska	0.81	0.12	0.69	85.3%
Arkansas	1.01	0.16	0.86	84.5%
Iowa	1.33	0.21	1.12	84.5%
South Dakota	0.34	0.05	0.29	84.5%
Oregon	1.61	0.25	1.35	84.2%
Minnesota	2.64	0.45	2.19	83.1%
New Hampshire	0.57	0.10	0.48	83.1%
Vermont	0.26	0.04	0.21	83.0%
South Carolina	1.73	0.30	1.43	82.9%
Wisconsin	2.55	0.44	2.11	82.7%
Oklahoma	1.33	0.24	1.09	82.0%
Alabama	1.67	0.30	1.36	82.0%
Alaska	0.25	0.05	0.21	81.6%
Mississippi	0.90	0.17	0.73	81.5%
Utah	1.25	0.24	1.01	80.4%
Kentucky	1.60	0.31	1.28	80.4%
New York	8.09	1.64	6.45	79.8%
Florida	7.26	1.49	5.77	79.5%
Missouri	2.47	0.52	1.95	79.1%
West Virginia	0.54	0.11	0.42	78.8%

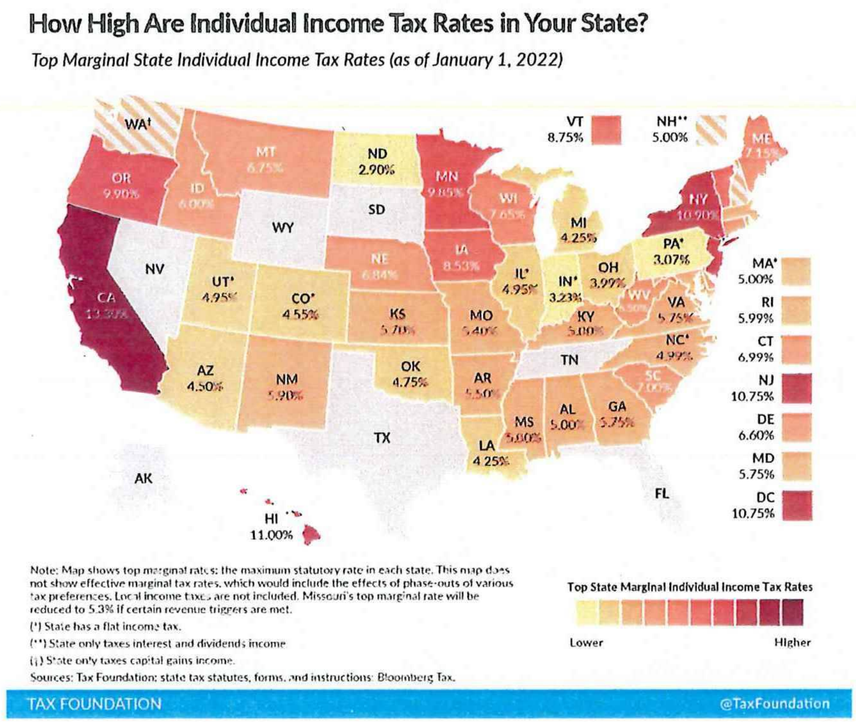
	Total employment (millions)	Public company employment (millions)	Private company employment (millions)	Private company employment share
Maryland	2.31	0.50	1.81	78.4%
Indiana	2.71	0.59	2.12	78.3%
Ohio	4.71	1.03	3.69	78.2%
Arizona	2.42	0.53	1.89	78.2%
Kansas	1.17	0.25	0.91	78.1%
North Carolina	3.73	0.82	2.91	77.9%
Louisiana	1.63	0.36	1.27	77.9%
New Mexico	0.62	0.14	0.48	77.4%
Illinois	5.28	1.21	4.07	77.1%
Pennsylvania	5.37	1.24	4.13	77.0%
New Jersey	3.57	0.83	2.75	76.9%
California	14.40	3.34	11.06	76.8%
Massachusetts	3.25	0.78	2.47	76.1%
Georgia	3.79	0.94	2.84	75.1%
Rhode Island	0.44	0.11	0.33	74.5%
Texas	10.35	2.70	7.65	73.9%
Michigan	3.76	1.00	2.77	73.5%
Colorado	2.30	0.65	1.65	71.7%
Virginia	3.31	0.97	2.34	70.6%
Tennessee	2.59	0.76	1.83	70.5%
Connecticut	1.50	0.45	1.05	69.9%
Idaho	0.57	0.17	0.39	69.5%
Washington	2.80	0.88	1.92	68.6%
Delaware	0.39	0.13	0.26	66.8%
Nevada	1.18	0.42	0.76	64.3%

Source: Tax Foundation

State and Local Tax Rate

California
- State income tax rate: 13.3%
- San Francisco income tax rate: 1.5%

Net income tax rate: 14.8%

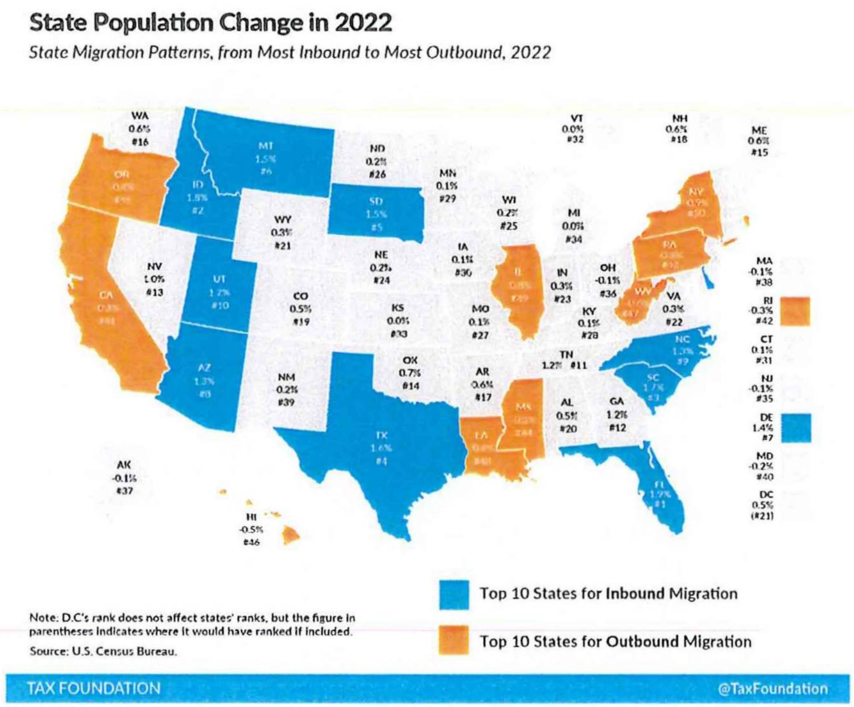


New York
- State income tax rate: 10.9%
- New York City income tax rate: 3.876%

Net income tax rate: 14.776%

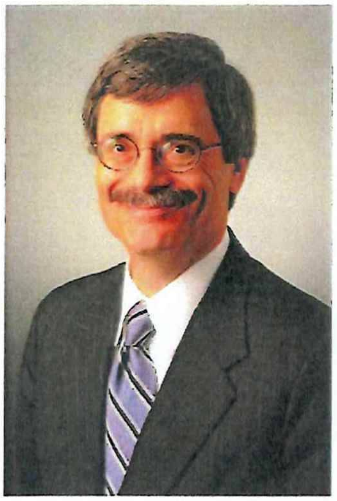
Source: Tax Foundation

State Migration



Source: Tax Foundation

CURRICULUM VITAE



Thomas J. Nichols is a shareholder in the Milwaukee law firm of Meissner Tierney Fisher & Nichols S.C., where he has been practicing corporate and tax law since 1979. The firm itself is over 170 years old, and is the second oldest firm in the state of Wisconsin. Mr. Nichols represents a wide array of clients ranging from start-ups, physician group, software, publishing, sales, restaurant, real estate and other closely-held concerns to insurance company, manufacturing and mutual fund advisory clients.

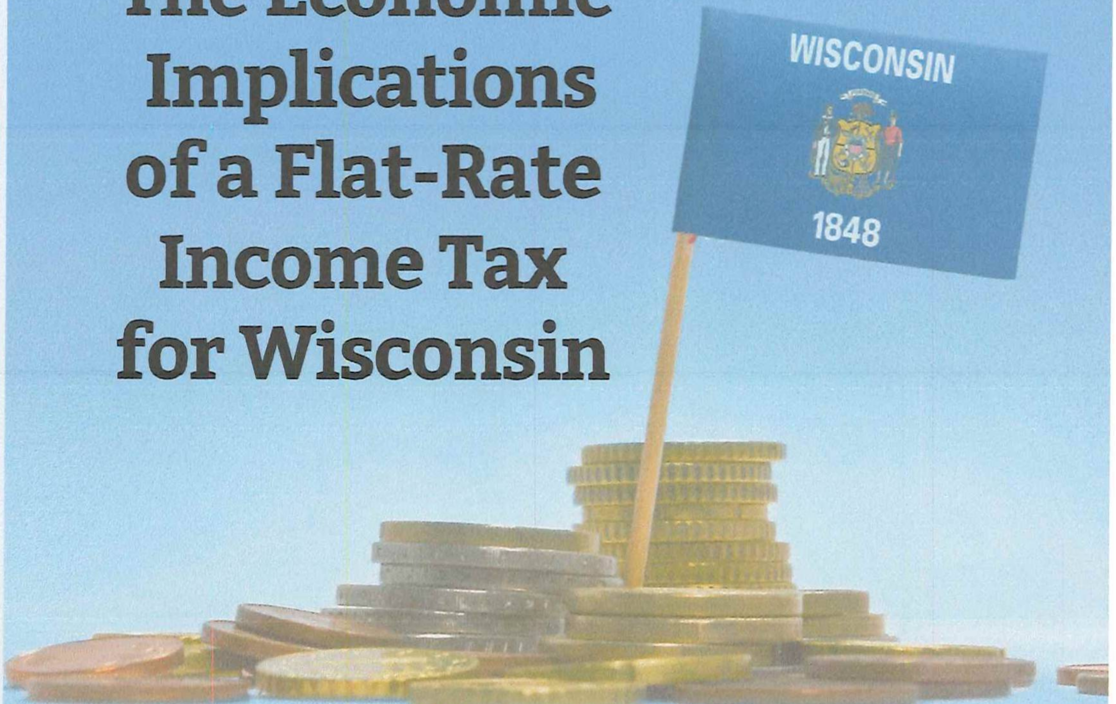
Mr. Nichols is Chairman of the Board of Advisors of the S Corporation Association and a past Chair of the S Corporations Committee of the ABA Section of Taxation, on which he has been active since 1987. In this capacity, Mr. Nichols has participated, as primary draftsperson or otherwise, in the preparation of the Committee's comments on the large majority of regulations that have been promulgated by the Treasury to implement the current S corporation provisions enacted in the Subchapter S Revision Act of 1982 and subsequent legislation, including those concerning pass-through income and loss, adjusted basis, corporate accounts, the single class of stock requirement, open account indebtedness, qualified subchapter S subsidiaries, the built-in gains tax, passive income, self-employment tax, back-to-back loans, the new net investment income tax and other S corporation rules. Mr. Nichols has also worked with House and Senate legislators and staff personnel on pending Tax Reform efforts, and has been a member of various ABA Tax Section Task Forces dealing with tax reform, including assisting in the preparation of its August 3, 2006 Comments on Additional Options to Improve Tax Compliance Prepared by the Staff of the Joint Committee on Taxation (for which he was listed as the contact person for S corporations). Mr. Nichols also participated extensively in Wisconsin's federalization of its S corporation statutes, where a number of his recommendations were adopted as statutory amendments. In addition, at the request of the Wisconsin Department of Revenue, Mr. Nichols reviewed and revised drafts of the Department's Publication 102, "Wisconsin Tax Treatment of Tax Option (S) Corporations and Their Shareholders," both in 1987 and again in 1998.

Mr. Nichols has also been and is actively involved in the development and updating of Wisconsin's business entity statutes, including the adoption of provisions on cross-species mergers and conversions between corporations, partnerships, limited liability companies and non-profit corporations, as well as Wisconsin's recent Business Entity Modernization Package (2021 Wisconsin Act 258) designed to update and improve the State's partnership, limited liability company and corporate statutes. He is a member of the Board of Directors of the Taxation Section of the State Bar of Wisconsin and Chair of the Partnerships Committee of the Business Law Section, as well as a Member and Past Chairman of the Wisconsin Taxation Committee of the Wisconsin Institute of Certified Public Accountants.

Mr. Nichols has spoken and written extensively on tax and business entity topics, including testimony before various committees of the U.S. House of Representatives, the ABA Tax Section, the New York University Institute on Federal Taxation, the American Law Institute–American Bar Association (ALI-ABA), the Tulane Tax Institute, the Southern Federal Tax Institute, the Accounting Continuing Professional Education Network (ACPEN), the State Bar of Wisconsin, the Wisconsin Institute of Certified Public Accountants, the Corporate Practice Institute and numerous other groups and institutions. Mr. Nichols is AV-rated by Martindale-Hubbell, and has been selected for inclusion in the *Best Lawyers in America®* and *Super Lawyers®* publications.

POLICY BRIEF • APRIL 2023

The Economic Implications of a Flat-Rate Income Tax for Wisconsin



By Donald Bruce, PhD,

Randy and Jenny Boyd Distinguished Professor,
Haslam College of Business, and Director,
Boyd Center for Business and Economic Research
The University of Tennessee, Knoxville

BADGER INSTITUTE

The Economic Implications of a Flat-Rate Income Tax for Wisconsin

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This report was commissioned by the Badger Institute and does not necessarily represent the opinions of the Institute or any of their employees or donors.

Executive summary

The individual income tax is a pillar of most state revenue systems in the United States, generating nearly a third of all state taxes. Wisconsin is one of numerous states with a graduated-rate progressive income tax, designed to raise the revenue necessary to fund public services while distributing the tax burden across the population in accordance with income. Progressive tax rates are often favored for their ability to reduce pre-tax differences in income between high-earning and low-earning households, which some view as unfair. Wisconsin's income tax has long been one of the most progressive, with a top rate of 7.65% that is eighth highest in the nation.

The world has changed in recent decades, as families have reevaluated the importance of work and income in their lives and have taken advantage of a very strong labor market to bargain for more flexible schedules and opportunities for remote work. Both the level and location of labor supply are more responsive to taxation than ever before. While steeply progressive marginal rates might be consistent with some definitions of fairness, they also distort economic activity if taxpayers work less, save less or move around to avoid high tax burdens. Policymakers must balance the need to achieve the desired degree of progressivity against the distortions to economic activity that result from taxation. Wisconsin's current income tax reflects a greater weight on progressivity, at the cost of potentially greater distortions to economic activity.

In the more than 100 years since Wisconsin enacted its first individual income tax, the progressivity at both the state and federal levels has been increased gradually and then reduced in response to growing awareness of taxpayer reactions to high tax rates. Indeed, 13 states already have flat-rate individual income taxes, including two of Wisconsin's largest neighbors (Illinois and Michigan).[1] Another 15 have only mildly progressive tax rate structures, and seven do not use an income tax at all.

The purpose of this report is to explore the economic impact of moving from Wisconsin's current progressive individual income tax (with a top rate of 7.65%) to a 5.1% flat-rate tax. A flat-rate tax could enhance economic efficiency by reducing top tax rates while adjusting standard deductions to ensure that taxpayers in lower tax brackets do not face a tax increase. Additionally, since most businesses are non-corporate entities, individual income tax policy is synonymous with business tax policy. A shift to a flat-rate individual income tax could represent a meaningful tax reduction for many Wisconsin businesses, potentially resulting in lower price growth, higher wage growth and more employment.

I estimate that a flat-rate income tax could generate nearly $7.2 billion in additional gross domestic product (GDP), $614 million in new investment and nearly 24,000 jobs over the next five years. These are substantial impacts, especially in light of the slow to negative projected growth in the next two years. As such, these are lower-bound estimates that would be even larger in more robust economic times.

Introduction

The individual income tax is a pillar of most state revenue systems, generating nearly a third of all state-level taxes in the U.S. Wisconsin has the distinction of having enacted the first broad-based state-level individual income tax in the nation in 1911, two years before the federal individual income tax took effect in 1913. That original Wisconsin income tax included 13 brackets, with marginal tax rates ranging from a low of 1% to a high of 6%.

This early tax was a prime example of a graduated-rate progressive income tax, designed to raise the revenue necessary to fund public services while distributing the tax burden across the taxpaying population in accordance with income.

Progressive tax rates are often favored for their ability to reduce pre-tax differences in income between high-earning and low-earning households, which some view as unfair. However, in the more than 100 years since Wisconsin enacted its first individual income tax, the progressivity at both the state and federal levels has been increased gradually and then reduced in response to growing awareness of taxpayer reactions to high tax rates. While steeply progressive marginal rates might improve fairness, according to some definitions, they also distort economic activity if taxpayers work less, save less or move around to avoid high tax burdens. This classic trade-off between progressivity and efficiency continues to influence the ongoing tax reform conversation at the state and federal levels.

The world has changed in recent decades, especially during and after the COVID-19 pandemic. Families have reevaluated the importance of work and income in their lives and have taken advantage of a very strong labor market to bargain for more flexible work schedules and opportunities for remote work. Agrawal and Stark (2022) provide evidence that labor supply and the physical location of labor are more responsive to taxation than ever before. Workers have proven that they can easily and effectively work from home and are increasingly realizing that home can be anywhere on the planet with access to good internet service and other necessary infrastructure.

In the face of this growing mobility of taxpayers and tax bases, state governments are wise to take a closer look at their revenue systems. As discussed by Agrawal and Stark (2022), it is no longer safe to assume that high-income mobile taxpayers will simply remain in their current state of residence or that taxpayers from other states will choose to relocate in a way that is blind to tax differences across states. Policymakers are wise to consider the potential negative impact of having high tax rates on increasingly mobile income.

Wisconsin is no exception, and a serious conversation is already underway about the merits of moving to a flat-rate tax on individual income. A flat-rate tax could enhance economic efficiency by reducing top tax rates while adjusting standard deductions to ensure that taxpayers in lower tax brackets do not face a tax increase. The purpose of this report is to explore the economic impact of moving from Wisconsin's current progressive individual income tax (with a top rate of 7.65%) to a 5.1% flat-rate tax.

I begin with a brief overview of Wisconsin's tax system, including discussions of the important topics of tax progressivity and business taxation. I then turn to a detailed simulation of the effects of a flat-rate tax on GDP, investment and employment. These impacts are compared for illustration to a set of baseline forecasts. To summarize, I estimate that a flat-rate income tax could generate nearly $7.2 billion in additional GDP, $614 million in new investment and nearly 24,000 jobs over the next five years. The report concludes with a brief discussion of other potential impacts.

Wisconsin's tax structure

According to data collected by the U.S. Census Bureau and tabulated by the Federation of Tax Administrators, Wisconsin received 40.5% of its state taxes from the individual income tax in 2021.[2] This exceeds the U.S. average of 39.7% across all states (plus the District of Columbia) regardless of whether they have an individual income tax, and it ranks as the 17th-highest reliance on the individual income tax in the nation. Nine states do not use a broad-based individual income tax (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington and Wyoming), and most of those rely much more heavily on general sales taxes.

Looking at combined state and local tax revenues, Wisconsin's reliance on individual income taxes for 27.4% of state and local taxes exceeds the national average of 22.8%.[3]

The Federation of Tax Administrators also gathers and tabulates data on key features of state individual income taxes.[4] Looking at tax rates for the 2023 tax year as of Jan. 1, 2023, Wisconsin's top marginal rate of 7.65% is the eighth highest among states. In four of the states with higher top marginal tax rates, the top rates take effect at much higher income levels than in Wisconsin: New York (10.9% starting at income of $25 million), New Jersey (10.75% starting at $1 million), Massachusetts (9% starting at $1 million) and California (12.3% starting at $677,275). Wisconsin's 7.65% rate takes effect at $304,170. The other four states with higher maximum marginal tax rates are Hawaii (11%), Minnesota (9.85%), Oregon (9.9%) and Vermont (8.75%), and those rates take effect at lower income levels than Wisconsin's top tax bracket. In sum, Wisconsin has one of the most progressive individual income tax systems in the nation.

Importantly, Wisconsin's top marginal income tax rate has been reduced since reaching historic highs in excess of 11% in the early 1970s. A shift to a 5.1% flat-rate income tax would not be a significant departure from this trend, representing the next step on a long path toward a flatter structure. While the series of statutory reductions in marginal tax rates and overall progressivity surely had many causes and goals, it is worth pausing to reflect on the optimality of progressive state taxation more broadly and state income taxation more specifically.

What about progressivity?

It is important to emphasize that while a shift to a flat-rate individual income tax in Wisconsin would represent a reduction in progressivity, it would not necessarily represent a reduction in fairness. To be sure, some concepts of fairness place greater weight on progressive tax structures. Others view progressive rates as inherently unfair, preferring tax structures where all taxpayers face a uniform marginal rate. Graduated marginal tax rates are only one method to build progressivity into a tax structure, however. One must also consider the size of standard deductions and other common deductions and credits that reduce tax burdens, especially for lower-income filers. And one must certainly consider the context of the entire fiscal system, including all tax and spending programs. It is not necessary for every single element of the fiscal system to reflect the broader progressivity goals as long as the entire system results in what is broadly viewed as a fair outcome.

A growing awareness of the sensitivity of economic activity to taxation has reignited the classic efficiency-progressivity debate in taxation. Specifically, while taxes need to generate revenue sufficient to fund the public programs demanded by voters, policymakers need to balance the need to achieve the desired degree of progressivity against the distortions to economic activity that result from taxation. Wisconsin's current income tax reflects a greater weight on progressivity at the cost of potentially greater distortions to economic activity.

To be sure, fairness is in the eye of the beholder. Some prefer graduated marginal tax rates as a way to link the tax burden to the individual's ability to pay as measured by their income. While income is not a perfect proxy for ability to pay (for example, some low-income taxpayers have high wealth while some high-income taxpayers have little wealth), it is generally accepted as a basis for taxation along with other proxies such as property wealth and consumption of sales-taxable items. Regardless of the chosen proxy, some prefer flat-rate structures such that everyone pays the same percentage of their income in tax.

Policymakers in many states have recognized that, because of the greater mobility of taxpayers across states and regions, redistribution through individual income taxes is more difficult to accomplish at the state level and is best left to the national level, which features a highly progressive individual income tax. Indeed, 11 states already have flat-rate broad-based individual income taxes, including two of Wisconsin's largest neighbors (Illinois and Michigan). Another 15 states have less progressive tax rate structures, with top rates taking effect at incomes below $100,000. And as noted, nine states do not even use a broad-based income tax at all. It seems that most income-taxing states value progressivity more at the lower end of the income distribution (that is, through lower tax rates and higher deductions) than at the higher end (through higher top tax rates).

To summarize, a shift to a flat-rate individual income tax in Wisconsin would represent an increase in fairness according to some definitions. And the fairness of a tax should certainly be evaluated within the context of the broader fiscal system, as many other tax and spending programs have effects on the distribution of economic resources in society.

What about business taxes?

This report is focused entirely on individual income taxes. That being said, it is critical to remember that most American businesses pay their income tax through the individual income tax. While corporations pay corporate income taxes, most businesses are non-corporate "pass-through" entities that are organized as sole proprietorships, partnerships, limited liability corporations and a host of other legal forms. Income generated by these entities passes through to the owners of the business, who pay tax on the income as part of their individual income tax.

Bruce, Gurley-Calvez and Murray (2015) document that pass-through entities accounted for more than one-third of business income and over 90% of business tax returns.[5] Loughead (2022) reports data from the IRS Statistics of Income showing that about 95% of Wisconsin businesses are pass-through entities taxed at the individual level. Individual income tax policy is synonymous with business tax policy for most types of businesses in Wisconsin.

To be sure, businesses do not pay taxes — people pay taxes. Businesses of all forms attempt to shift their tax burdens forward to consumers (through higher prices) and backward to employees and input suppliers (through lower wages or employment, or lower input prices) before paying out of profits. And for publicly traded companies, reduced profits typically translate into lower shareholder value, negatively affecting anyone with a diversified retirement account or other savings that is invested in stocks and bonds. A shift to a flat-rate individual income tax in Wisconsin would represent a meaningful tax reduction for many Wisconsin businesses, which then should result in lower price growth, higher wage growth, more employment and higher shareholder value.

Simulating the economic impacts of a flat-rate income tax in Wisconsin

A shift to a 5.1% flat-rate individual income tax could have important economic benefits for Wisconsin. On the surface, reducing the top two marginal tax rates would have the direct effect of increasing the after-tax return to work effort and investment, which should result in greater economic activity, including business formation, investment and employment. Doing so in the proposed revenue-reducing fashion (that is, without simultaneously making up the lost income tax revenue elsewhere) would essentially return considerable funds to the taxpayers, potentially creating ripple effects throughout the state's economy.

I now turn to a detailed discussion of simulated effects of a shift to a flat-rate income tax on several major economic indicators: GDP, investment and employment. I motivate each of these with a brief overview of the available empirical literature, lessons from which guide the simulation analysis. Impacts are expressed in annual percentage terms and also converted into cumulative five-year effects in dollars and jobs.

For purposes of illustration, I compare simulated impacts to the best available macroeconomic forecasts for these series. I emphasize that economic forecasters are generally predicting slower growth in GDP and investment alongside outright declines in employment for the next two years before gradually returning to longer-term trends. As a result, my simulated impacts can be viewed as lower bounds; economic impacts would be much larger in a more robust expansionary environment. I provide additional discussion for each outcome measure below.

GDP

A vast literature has explored the impact of taxes on economic growth.[6] To be sure, the impact of a tax reduction (or a revenue-reducing shift to a flat-rate income tax) on economic growth would depend critically on whether government spending would be reduced simultaneously by an equivalent amount. It is important to emphasize again that the simulations in this report are not assumed to be revenue-neutral or budget-neutral. The specific shift to a flat-rate income tax that is the focus of the present analysis certainly would reduce tax revenues, and the emphasis here is on the economic impact of returning those dollars to the taxpayers.

Estimates from this literature are quite diverse, based on a variety of different underlying assumptions and contexts. For example, Dennis et al. (2004) provide a range of estimates from a 1.5% decrease to a 0.8% increase in GDP from a 10% cut in income tax rates, while Barro and Redlick (2011) estimate that a revenue-neutral reduction in average marginal tax rates of 1 percentage point would increase per capita GDP by 0.5%. Romer and Romer (2010) estimate much larger positive impacts, but Favero and Giavazzi (2009) have questioned their underlying assumptions.

I focus the analysis on two studies that are more directly related to the present context and fall in the middle of the wider set of available estimates. Specifically, Mertens and Ravn (2013) and Carroll et al. (2001) examine the impact of income tax rate changes on economic activity. Mertens and Ravn (2013) estimate that a 1 percentage point tax rate cut would increase the taxable base by 1.6%, while Carroll et al. (2001) provide an estimate that is about half as large (0.84%). Closely following Bruce, Gurley-Calvez and Murray (2015), I convert the Mertens and Ravn (2013) and Carroll et al. (2001) estimates into similarly defined elasticities and use the average of the two. The result is an average elasticity of 0.57, which I apply to a weighted-average tax rate reduction as described below.

To calculate the weighted average marginal tax rate reduction, I first examine the distribution of households by total income using distributional tables from the Wisconsin Department of Revenue (2019). While distributions across marginal income tax rate brackets are not available, I am able to approximate these distributions from the available data.

Table 3

Simulated impacts of a 5.1% flat tax on investment

Year	Baseline forecast* Investment ($ millions)	Baseline forecast* Investment growth	Simulated with 5.1% flat tax Investment ($ millions)	Simulated with 5.1% flat tax Investment growth	Additional investment ($ millions)
2022	49,937				
2023	49,853	-0.17	49,973	0.07	120
2024	50,554	1.41	50,674	1.65	120
2025	51,658	2.18	51,779	2.42	122
2026	53,309	3.20	53,433	3.44	124
2027	55,222	3.59	55,350	3.83	128
				Cumulative impact:	$614 million

**Forecast sources: Author's estimates based on the February 2023 forecast of U.S. GDP from IHS Markit and Wisconsin Department of Revenue (2022). See text for additional details.*

Applying this 0.64 percentage-point weighted average tax rate reduction to the average GDP elasticity of 0.57 results in an annual GDP impact of 0.366 percentage points. While this impact might appear to be small upon initial observation, it is quite substantial when compared to the average rate of growth of nominal Wisconsin GDP of 3.4% between 2010 and 2021. Shifting to a flat-rate income tax of 5.1% could result in annual growth that is more than 10% faster than historic trends. As shown in Table 2, this would translate into about $1.2 billion to $1.6 billion in additional GDP per year, totaling nearly $7.2 billion over the next five years, relative to the most recent economic forecast from the Wisconsin Department of Revenue (2022).[7]

INVESTMENT

Gauging the effects of a shift to a flat-rate income tax on business investment for a single state is complicated by the absence of useful state-level data in the GDP accounts. To provide a useful baseline for simulation purposes, I assume that Wisconsin's share of national investment equals the state's share of national GDP. To the extent that Wisconsin's investment share of GDP is higher than the nation's, this simulation will yield a lower bound on the effects of a flat-rate tax. All other steps in my simulation process follow those for GDP as outlined above.

For an elasticity, I rely exclusively on Carroll et al. (2000a), who estimate that a 5 percentage point increase in marginal tax rates would reduce investment by about 9.9%. This converts to an average elasticity of about 0.376, which I apply to the above weighted average tax rate reduction. The impact from the shift to a flat-rate income tax would be on the order of about 0.241 percentage points per year (or about 5.5% faster growth in annual investment when compared to the 2010-2021 average annual growth of 4.38%). As shown in Table 3, this would represent additional investment of about $120 million to $130 million per year, or about $614 million over the next five years.[8]

EMPLOYMENT

Several prior studies have examined the effects of tax rates on employment. As summarized by Chetty (2012), elasticities of work with respect to changes in tax rates center on 0.25 on the extensive (that is, participation) margin and 0.33 on the intensive (that is, hours or effort) margin. I focus again on Mertens and Ravn (2013) and Carroll et al. (2000b) for the purposes of my simulations. Specifically, Mertens and Ravn (2013) estimate that a 1 percentage point tax rate cut would increase per capita employment by about 0.8%, while Carroll et al. (2000b) estimate an elasticity of wage payments to tax prices of 0.37. Converting these to similar elasticity concepts yields an average elasticity of employment with respect to tax rates of 0.257, which I apply to the weighted average marginal tax rate change as before.

These calculations result in annual employment impacts from the shift to a flat-rate income tax of 0.165 percentage points,

Table 4

Simulated impacts of a 5.1% flat tax on employment

	Baseline forecast*		Simulated with 5.1% flat tax		
Year	Employment (1,000s)	Employment growth	Employment (1,000s)	Employment growth	Additional employment (1,000s)
2022	2,941				
2023	2,930	-0.40	2,934	-0.24	4.4
2024	2,909	-0.70	2,914	-0.54	4.9
2025	2,920	0.40	2,925	0.56	5.0
2026	2,928	0.25	2,933	0.42	4.8
2027	2,933	0.19	2,938	0.35	4.8
				Cumulative impact:	**23,947 jobs**

**Forecast sources: Wisconsin Department of Revenue (2022) for 2022-2025. Forecasts for 2026 and 2027 are the author's estimates based on the February 2023 forecast of U.S. employment from IHS Markit.*

which is quite large when compared to the 2010-2021 average annual employment growth of 0.438%. Indeed, the annual impact of the shift to a flat-rate income tax would be on the order of 4,500 to 5,000 more jobs per year, or nearly 24,000 jobs over the next five years. It is important to note that the annual impacts in 2023 and 2024 would only partially offset the decline in employment projected by the Wisconsin Department of Revenue (2022) in its most recent forecast. As with GDP and investment, employment impacts would be much more substantial in an expansionary environment.

Additional economic impacts

While not the focus of this study, I briefly consider two additional areas of potential economic impact: new firm formation and interstate migration. Beginning with new firm formation, Bruce, Gurley-Calvez and Norwood (2020) summarize the growing empirical literature and conclude that most studies have found little to no impact of state-level income taxes on various measures of entrepreneurial activity. However, the broader empirical literature has found important positive impacts of across-the-board tax rate reductions or reductions in progressivity, and those results could be important to the Wisconsin case.

Specifically, based on the findings of Gurley-Calvez and Bruce (2008 and 2013), it is reasonable to expect that a shift from the current graduated-rate income tax to a flat-rate structure would create important advantages to potential entrepreneurs, especially those in the top tax rate bracket. The two Gurley-Calvez and Bruce studies indicate that marginal tax rate reductions could increase small business formation (2013) and longevity (2008). I would anticipate similar effects in Wisconsin from a shift to a flat-rate income tax structure.

Turning to interstate migration, Kleven, Landais, Munoz and Stantcheva (2020) provide a recent summary of the large and growing literature that has explored the extent to which taxpayers relocate in response to tax rates. To be sure, the proposed Wisconsin flat-rate income tax might not appear to be large enough to generate a substantial migration response because the state's top marginal tax rate already has been reduced substantially from a high of 11.4% in the mid-1970s.

That said, while the proposed reduction of up to 2.55 percentage points from a flat tax would be smaller than the last substantial reduction experienced during the mid-1980s (from 10.0% to 6.77%), it would follow the more recent 2009 increase of one percentage point (from 6.75% to 7.75%) and would occur within the context of other states reducing their tax rates.

It is important to keep two significant factors in mind when assessing migration impacts, however. First, the COVID-19 pandemic has made it much easier to work remotely, breaking the linkage between one's place of work and place of

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Endnotes

[1] While eleven of these apply to broad income concepts, two apply only to capital income. New Hampshire has a flat-rate tax on interest and dividend income and Washington has a flat-rate tax on capital gains income of high earners. Two states, Georgia and Iowa, are currently transitioning towards flat-rate income tax structures.

[2] Data are available at https://taxadmin.memberclicks.net/2021-state-tax-collection-by-source. The Wisconsin Department of Revenue reports that individual income taxes were a higher percentage (44.8%) of state revenues in 2022. Those data can be found at https://public.tableau.com/app/profile/research.policy/viz/Act66StateFiscalDashboard/Story1. We use FTA data for its comparability across states.

[3] Data are available at https://taxadmin.memberclicks.net/2020-state-and-local-revenues-by-source.

[4] The most recent table can be found at https://taxadmin.memberclicks.net/assets/docs/Research/Rates/ind_inc.pdf.

[5] IRS Integrated Business Statistics. http://www.irs.gov/uac/SOI-Tax-Stats-Integrated-Business-Data.

[6] See McBride (2012) or Gale and Samwick (2014) for an exhaustive and useful survey.

[7] The Wisconsin DOR (2022) projects GDP through 2025. For the purposes of these illustrations, I extend their projections through 2027 by adjusting IHS Markit's national GDP growth forecast for the 2011-2019 ratio of Wisconsin GDP growth to U.S. GDP growth.

[8] For illustration purposes, I construct a baseline forecast of Wisconsin investment by applying the same GDP ratios to the IHS Markit forecast of U.S. investment growth. Where necessary, inflation-adjusted forecasts are converted to current-year nominal dollars because I do not forecast inflation-adjusted impacts in this report.

Esbeck, Nicholas

From:	Marian Krumberger <mariankru@gmail.com>
Sent:	Friday, April 21, 2023 6:29 AM
To:	Sen.Hutton; Sen.James; Sen.Nass; Sen.Ballweg; Sen.Cabral-Guevara; Sen.Larson; Sen.Roys; Sen.Smith; Sen.Pfaff
Cc:	Rep.Vos; Sen.LeMahieu; Sen.Wimberger
Subject:	Senate Bill 1 Flat Tax

Senate Committee on Universities and Revenue:

We favor the support of Senate Bill 1, flat tax, only if it is a step toward no state income tax. An analysis from the Tax Foundation using Commerce Department data shows that states without an income levy grew at twice the national rate over the past decade, while gross state economic output grew 56 percent faster in those locations over the same period. States with no income tax become better beacons for growth, creating more jobs and retaining a core of young, educated workers who don't feel the need to move to other states with lower tax burdens. Nine states already have no state tax on personal earned income.

As a first step, a low (say 2% or less of adjusted income) flat tax would be a good first step. The simplicity of a flat tax with no deductions allows all taxpayers to fill out their own tax forms, virtually eliminating the cost of professional tax preparers. Applying the same rate to all taxpayers is the fairest tax, especially if the rate is kept low.

No discussion of public finance is complete without considering spending and productivity. Our state needs to establish productivity measures in every department of state government with a mandate to improve the quality of service while operating on 2% less revenue in each of the next five years. Private businesses achieve such competitive goals routinely. Government can and must do the same.

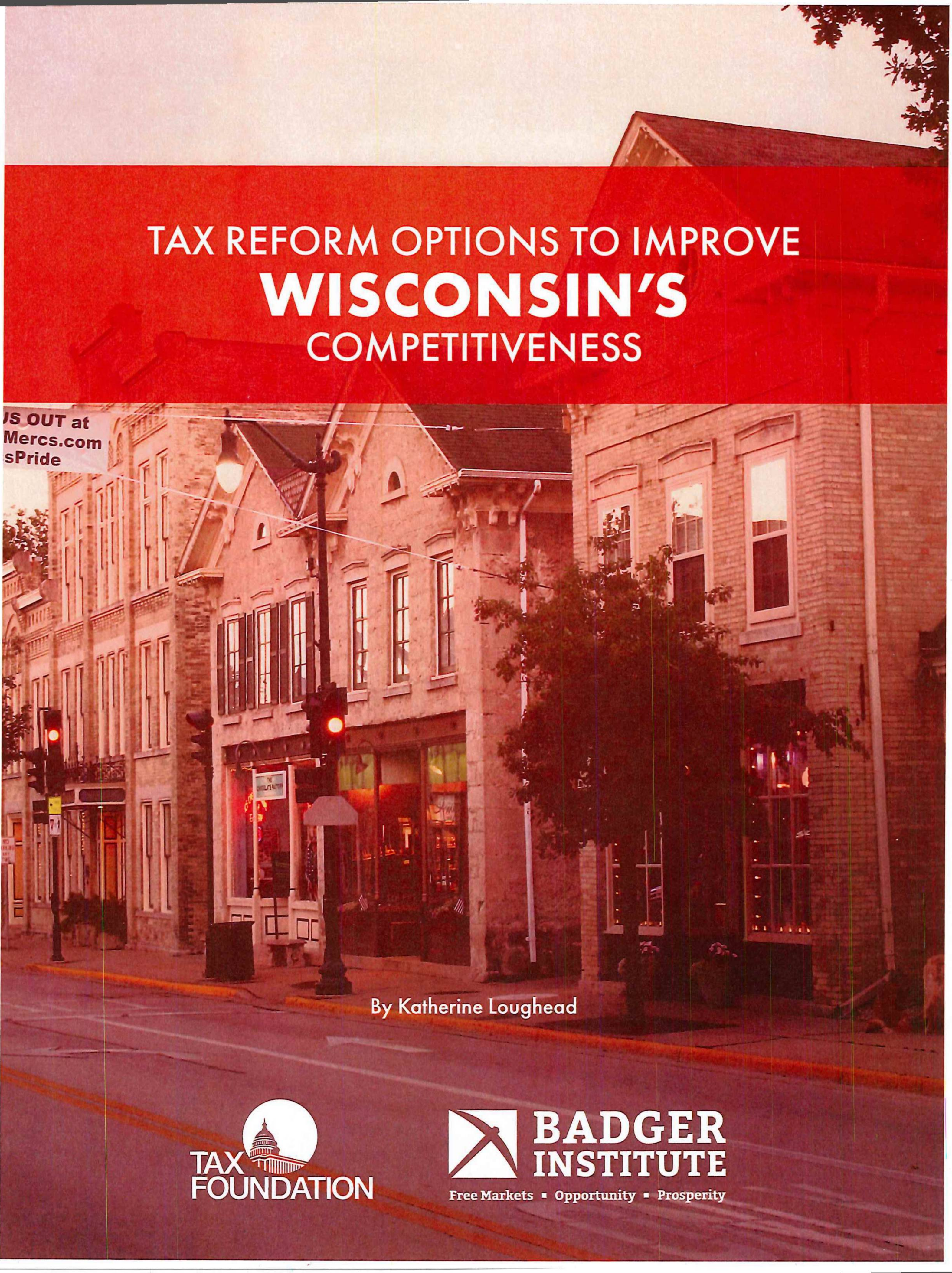
Ultimately, the elimination of Wisconsin state income taxes will be a competitive necessity in the twenty-first century.

Thank you for the opportunity to provide input.

Sincerely,

Frederick and Marian Krumberger
3196 Harbor Winds Drive
Suamico, Wisconsin 54173

TAX REFORM OPTIONS TO IMPROVE **WISCONSIN'S** COMPETITIVENESS



By Katherine Loughead

TAX FOUNDATION

BADGER INSTITUTE

Free Markets ▪ Opportunity ▪ Prosperity

TAX REFORM OPTIONS TO IMPROVE **WISCONSIN'S** COMPETITIVENESS

By Katherine Loughead

Key Findings

- Over the past two years, a wave of tax reform has swept the country, with a historic number of states improving their tax competitiveness by reducing income tax rates and enacting flatter structures.
- Since 2019, Wisconsin has made improvements to its three lowest marginal individual income tax rates, but its top marginal rate of 7.65 percent remains among the highest in the country.
- A new era of increased remote work flexibility is contributing to states' decisions to reduce income tax rates, and states that stand still risk falling behind their peers.
- Wisconsin's state sales tax rate is among the lowest in the country, and the sales tax base excludes many consumer services.
- Numerous economic studies show corporate and individual income taxes are more harmful to economic growth than are consumption taxes.
- Given Wisconsin's strong budget surplus and continued projected revenue growth, policymakers have a solid opportunity to rebalance Wisconsin's tax structure by shifting reliance away from economically harmful taxes on productivity and toward less harmful taxes on consumption.
- This report offers five sample comprehensive tax reform options to enhance Wisconsin's tax competitiveness with a focus on reducing economically harmful taxes on labor and investment.

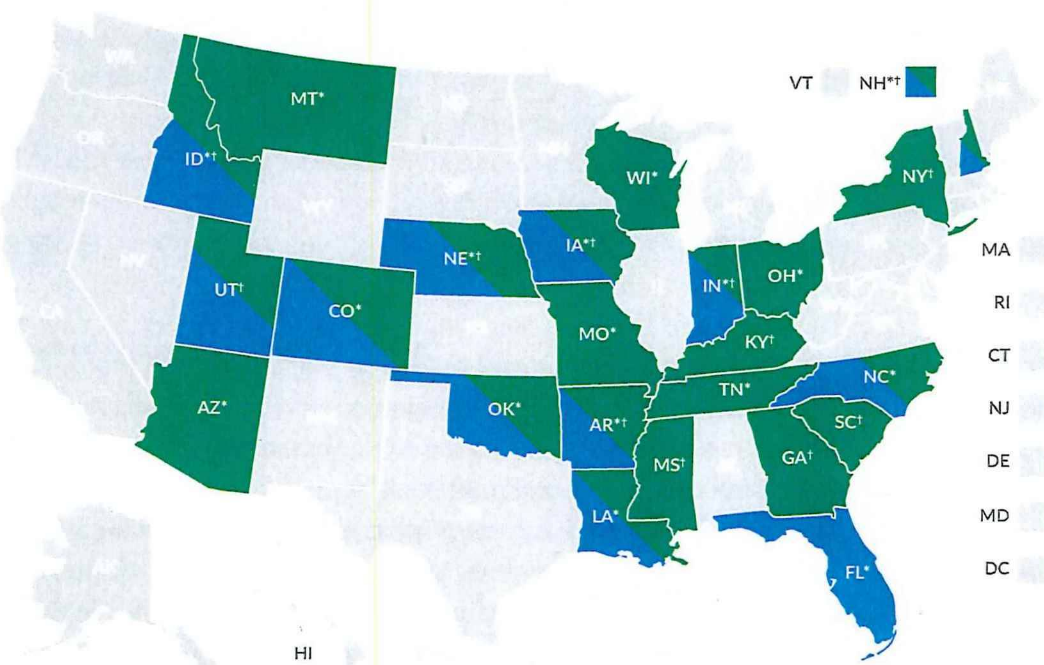
Introduction

Over the past two years, a wave of tax reform has swept the country, with a historic number of states enacting laws to improve tax competitiveness. In 2021, Wisconsin was among 13 states to enact laws reducing individual or corporate income tax rates, and as of this writing, 11 states have enacted legislation in 2022 to reduce income tax rates. Six of these tax-cutting states sit within a 200-mile radius of Wisconsin, creating an intensely competitive regional tax environment.

FIGURE 1.

Income Tax Rate Reductions Enacted or Implemented in 2021 and 2022

As of June 23, 2022



Individual Income Tax Reduction

Corporate Income Tax Reduction

* Rate reduction enacted/implemented in 2021

† Rate reduction enacted/implemented in 2022

Note: In Florida, a corporate income tax rate reduction was automatically triggered for 2021 only. Colorado's Taxpayer's Bill of Rights (TABOR) triggered a temporary individual and corporate income tax rate reduction for 2021. New Hampshire does not tax wage and salary income, but its tax on individual interests and dividends income is phasing out over time. Tennessee's tax on interests and dividends income, the Hall Tax, was eliminated effective January 1, 2021.

Source: Tax Foundation.

In 2019, 2020, and 2021, Wisconsin reduced its second-highest individual income tax rate once and its lowest two rates twice, targeting tax relief toward low- and middle-income taxpayers. But Wisconsin's top marginal individual income tax rate—which applies to approximately two-thirds of pass-through business income—has been left unchanged for a decade, and the state income tax landscape has grown dramatically more competitive during that time. In fact, 25 states have lower top marginal individual income tax rates now than they did in 2012.[1] As of 2023, when Iowa's top rate drops to 6 percent (with further reductions to 3.9 percent),[2] Minnesota and Wisconsin will be left with the highest top marginal individual income tax rates of all the non-coastal states stretching from California to New York.[3]

1 Jared Walczak, "Two Dozen States Show Why the Kansas Critique of Income Tax Cuts Is Mistaken," Tax Foundation, May 24, 2022, https://www.taxfoundation.org/kansas-experiment-kansas-tax-cuts-critique/.

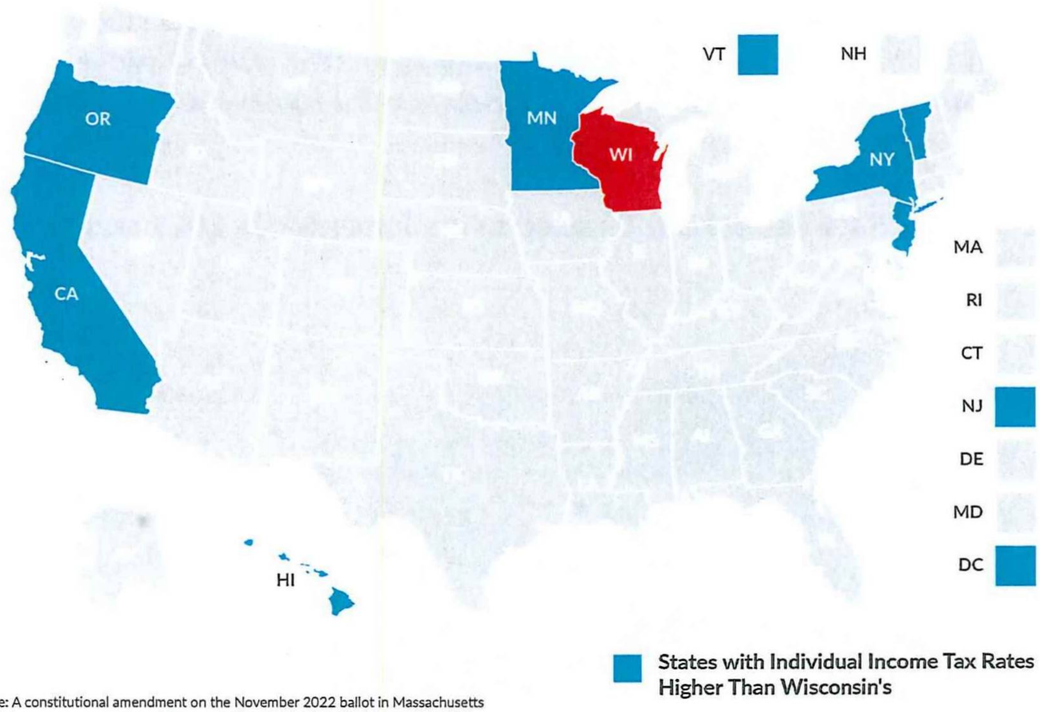
2 Jared Walczak, "Iowa Enacts Sweeping Tax Reform," Tax Foundation, Mar. 14, 2022, https://www.taxfoundation.org/iowa-tax-reform/.

3 Timothy Vermeer and Katherine Loughead, "State Individual Income Tax Rates and Brackets for 2022," Tax Foundation, Feb. 15, 2022, https://www.taxfoundation.org/publications/state-individual-income-tax-rates-and-brackets/.

FIGURE 2.

States with Individual Income Tax Rates Higher Than Wisconsin's

Expected as of January 1, 2023



Note: A constitutional amendment on the November 2022 ballot in Massachusetts would create a new top rate of 9 percent that would take effect January 1, 2023.
Source: Tax Foundation.

Adding to the urgency of reform, the COVID-19 pandemic quickly accelerated a trend toward more flexible workplace arrangements, and many workers now find themselves free to live in a state of their choosing while working for an employer in another. With enhanced workplace flexibility and with inflation at its highest level in four decades, many people are leaving high-tax, high cost-of-living jurisdictions in favor of states with lower costs of living, including lower taxes—specifically, states with low or no income taxes.

Individuals and businesses weigh many factors when deciding where to locate or invest—such as family and weather, as well as infrastructure, quality of life, and a suitable workforce. Not many of these factors are within policymakers' control, and, even when they are, economic growth generated from educational improvements or infrastructure investments, for example, may take years to manifest. But tax policy *is* within policymakers' control, and policy changes can yield real economic results much more quickly.

Even with the improvements Wisconsin has made since 2019, the state is quickly falling behind on income tax competitiveness, and this has implications both for business investment and for Wisconsin's ability to attract and retain a highly skilled workforce.

This publication presents five sample comprehensive tax reform options for Wisconsin and explains how each of the proposed policy changes would help Wisconsin become more economically competitive. Several components of these sample tax reform options are similar to the components of the reform options that were presented in our 2019 publication *Wisconsin Tax Options: A Guide to*

Fair, Simple, Pro-Growth Reform,[4] but these new options reflect current tax collections and revenue forecasts, as well as recent tax policy changes in Wisconsin.

An Overview of Wisconsin's Tax Structure

The Tax Foundation's *State Business Tax Climate Index*, published annually, evaluates states according to the competitiveness of their tax structures. In the 2022 edition of the *Index*, which is based on a snapshot of policies in place on July 1, 2021, Wisconsin ranks 27th overall, slightly below average.[5] Wisconsin's scores on the individual, corporate, and unemployment insurance tax components drag down its overall score, but the state performs in the top 10 on sales and excise taxes and among the top 20 on property and wealth taxes. Table 1 shows Wisconsin's 2022 *Index* rankings and how they have changed since the 2019 version of the *Index*,[6] which was referenced in our February 2019 publication *Wisconsin Tax Options: A Guide to Fair, Simple, Pro-Growth Reform*.

Wisconsin's recent individual income tax rate reductions contributed to its improvement on the individual tax component, and reductions in property tax collections per capita and property taxes as a percentage of personal income contributed to its improvement on the property and wealth tax component.

Since unemployment insurance (UI) tax systems are similar in every state, a small change in one state's policies can change its UI tax component ranking dramatically. Rates, meanwhile, fluctuated considerably from state to state during the pandemic. This explains the large improvement in Wisconsin's UI tax ranking that occurred due to minor taxpayer-friendly improvements in the state's UI tax structure combined with significantly higher rate schedules in some peer states.

TABLE 1.

Wisconsin's *State Business Tax Climate Index* Rankings

Component	2019 Rankings (Backcast)	2022 Rankings	Change
Overall Ranking	33	27	+6
Corporate Taxes	31	31	--
Individual Taxes	39	37	+2
Sales and Excise Taxes	7	7	--
Property and Wealth Taxes	20	16	+4
Unemployment Insurance Taxes	40	28	+12

Note: The *State Business Tax Climate Index* measures how each state's tax laws affect economic performance. A rank of 1 means the state's tax system is more favorable for business; a rank of 50 means the state's tax system is less favorable for business. Some 2019 rankings referenced here differ from rankings as originally published in the 2019 Index due to enactment of retroactive statutes and backcasting of methodological changes.

Source: Tax Foundation, 2022 *State Business Tax Climate Index*.

4 Katherine Loughead, Jared Walczak, and Joseph Bishop-Henchman, "Wisconsin Tax Options: A Guide to Fair, Simple, Pro-Growth Reform," Tax Foundation, Feb. 13, 2019, 40, https://www.taxfoundation.org/wisconsin-tax-reform/.

5 Janelle Fritts and Jared Walczak, *2022 State Business Tax Climate Index*, Tax Foundation, Dec. 16, 2021, https://www.taxfoundation.org/2022-state-business-tax-climate-index/.

6 Some 2019 rankings referenced here differ from rankings as originally published in the 2019 *Index* due to enactment of retroactive statutes and backcasting of methodological changes.

Sample Tax Reform Options for Wisconsin

Our February 2019 publication *Wisconsin Tax Options: A Guide to Fair, Simple, Pro-Growth Reform* presented a menu of four comprehensive tax reform options for the state. All four options were approximately revenue neutral based on the revenue estimates and other data that were available at the time. Much has changed, though—in our world, in state tax policy, and even in Wisconsin's tax code—over the past three years. Following the U.S. Supreme Court's decision in *South Dakota v. Wayfair*, the state enacted a law requiring remote sellers and marketplace facilitators with more than $100,000 in sales into Wisconsin to collect Wisconsin's state and local sales taxes. This resulted in an influx in sales tax revenue, which Wisconsin used to permanently reduce, on two separate occasions, the two lowest marginal individual income tax rates.

Wisconsin's policy of collecting sales taxes from remote sellers proved fortuitous during the COVID-19 pandemic, when a great deal of consumption shifted online. Then, like most states, Wisconsin experienced strong own-source revenue growth in fiscal years (FYs) 2020-21 and 2021-22 and was one of 13 states to enact laws in 2021 reducing income tax rates.

In light of these changes, we chose to publish updated tax reform options that take into account the aforementioned changes to Wisconsin's tax code and to the state tax landscape, as well as the most up-to-date Wisconsin tax collections figures and revenue projections. Several of the reform options we present in the pages to follow are similar to the options presented in our 2019 report, with some variations. Most notably, the updated options prioritize highlighting ways Wisconsin could move from a graduated-rate to a flat individual income tax, as four states have enacted laws to do since July 2021.

Given that Wisconsin is projecting continued revenue growth above the current baseline and is expecting to close out the FY 2021-23 biennium with a budget surplus of $3.8 billion,[7] Wisconsin has plenty of extra revenue to return to taxpayers in the form of permanent rate reductions and other structural improvements. As such, each of our sample comprehensive tax reform options would return approximately $1.2 billion of this revenue growth to taxpayers. Options A, B, and C would use sales tax base broadening and/or rate increases to offset the additional cost of income tax reductions above $1.2 billion, while Options D and E would each provide a sustainable net tax cut of approximately $1.2 billion without sales tax base broadening or rate increases, meaning the income tax cuts in Options D and E are smaller than in Options A, B, and C.

It is important to note, however, that rates could be dialed down even further if policymakers want to provide more than $1.2 billion in net tax relief, and rates could be dialed up slightly if policymakers want to dedicate less of the state's revenue growth to tax relief.

Table 2 shows a summary of the provisions included in each comprehensive tax reform option, and Table 3 shows how the flat individual income tax rates in Options A through D could be dialed down or up depending on the amount of revenue growth lawmakers choose to return to taxpayers.

Detailed descriptions of each sample tax reform option are provided in the pages that follow.

7 Wisconsin Legislative Fiscal Bureau, Letter on state's general fund to state Senate chair Sen. Howard Marklein and state Assembly chair Rep. Mark Born, Jan. 25, 2022; Deneen Smith, "State Expects $3.8 Billion Surplus," Wisconsin Public Radio, Apr. 26, 2022, https://www.urbanmilwaukee.com/2022/04/26/state-expects-3-8-billion-surplus/.

TABLE 2.

Five Sample Tax Reform Options for Wisconsin

Net Tax Cut of $1.2 Billion

	Current Structure (Tax Year 2022)		Option A	Option B	Option C	Option D	Option E	
Individual Income Tax								
	Single	MFJ	All filers	All filers	All filers	All filers	Single	MFJ
	3.54% > $0	3.54% > $0	4.15%	4.5%	4.5%	5.1%	3.3% > $0	3.3% > $0
	4.65% > $12,760	4.65% > $17,010					4.4% > $12,760	4.4% > 17,010
	5.30% > $25,520	5.30% > $34,030					5.0% > $25,520	5.0% > $34,030
	7.65% > $280,950	7.65% > $374,600					7.2% > $280,950	7.2% > $374,600
Enhanced standard deduction			✓	✓	✓	✓	✓	
Corporate Income Tax								
Rate	7.9%		7%	5.5%	6.5%	7.9%	7%	
Throwback rule repealed			✓	✓	✓		✓	
Economic development surcharge repealed			✓	✓	✓		✓	
Sales Tax								
Rate	5%		6%	6%	6%	5%	5%	
Modest base broadening			✓	✓				
Property Tax								
Personal property tax repealed			✓	✓	✓	✓	✓	
Results of Proposed Changes								
State Business Tax Climate Index ranking	27th		8th	8th	9th	9th	21st	

Note: See text for description of enhanced standard deduction and Table 6 for components included in sales tax base broadening. The *State Business Tax Climate Index* ranking line shows what Wisconsin's overall ranking on the 2022 *Index* would have been if sample options had been in effect on July 1, 2021.

Sources: Tax Foundation calculations based on data from the Wisconsin Legislative Fiscal Bureau and the Wisconsin Department of Revenue.

TABLE 3.

Sample Flat Individual Income Tax Rates Under Alternative Net Tax Cut Scenarios

Net Tax Cut	Option A	Options B and C	Option D
$1 billion	4.30%	4.60%	5.20%
$1.2 billion	4.15%	4.50%	5.10%
$1.4 billion	4.00%	4.40%	5.00%
$1.6 billion	3.90%	4.25%	4.85%
$2 billion	3.80%	4.10%	4.70%

Sources: Tax Foundation calculations based on data from the Wisconsin Legislative Fiscal Bureau and the Wisconsin Department of Revenue.

Option A

The primary goal of Option A is to create a more competitive individual income tax structure by consolidating four brackets into one and reducing the rate substantially, to a flat 4.15 percent, lower than the flat rates in neighboring Illinois and Michigan. This option also includes a modest reduction to the corporate income tax rate, bringing it down nearly a percentage point, to 7 percent. To partially offset these reforms (above the $1.2 billion in assumed reductions against higher revenues), Option A would modestly broaden the sales tax base (see Table 6), while increasing the sales tax rate to 6 percent.

By adopting a single-rate individual income tax at a substantially lower rate, this approach would reduce Wisconsin's overreliance on taxes on productivity, reducing the degree to which the tax code discourages additional investment and labor force participation. Modernizing the sales tax to include a wider range of consumption, particularly from higher earners, would inject progressivity into the sales tax while making it more neutral in its application to both goods and services. With a state sales tax rate of 6 percent, Wisconsin's combined state and average local sales tax rate would be 6.43 percent, which would still be lower than the combined rates in 31 of the 45 states with statewide sales taxes.[8]

Option B

Option B prioritizes making both the individual and corporate income tax rates substantially more competitive, bringing the individual income tax rate to a flat 4.5 percent, lower than the rate in Illinois, and the corporate income tax rate to 5.5 percent. To partially offset these reforms, Option B would modestly broaden the sales tax base while increasing the sales tax rate to 6 percent.

This option gives greater priority to enhancing the competitiveness of Wisconsin's corporate income tax, a tax which falls on—and thus discourages—capital investment. Corporate income taxes are a small and declining share of state tax revenue across the country, as states acknowledge their disinducement to investment and confront the revenue volatility they add to state tax codes.

Option C

Option C's individual income and sales tax rates are identical to those of Option B, but instead of achieving a substantially lower corporate income tax rate, Option C trims the corporate income tax rate to 6.5 percent while leaving the sales tax base unchanged.

Like Option B, by reducing both individual and corporate income taxes, Option C would make Wisconsin more attractive to all types of businesses, regardless of their legal structure. Even with a full percentage point increase in Wisconsin's sales tax rate, the combined state and average local sales tax rate would still be lower than the rates in 31 of the 45 sales tax-levying states.

8 Janelle Fritts, "State and Local Sales Tax Rates, 2022," Tax Foundation, Feb. 3, 2022, https://www.taxfoundation.org/publications/state-and-local-sales-tax-rates/.

Option D

If policymakers want to achieve a flat individual income tax rate without offsetting sales tax rate or base changes, Option D presents one possible method for doing so. This option assumes Wisconsin's general fund has grown enough in recent years to permanently return $1.2 billion to taxpayers. This is a conservative assumption, as the state is projected to end the FY 2021-23 biennium with a surplus of $3.8 billion,[9] and while the growth *rate* is likely to slow, general fund tax collections for FY 2022-23 are projected to exceed collections for FY 2021-22, just like FY 2021-22 collections exceeded FY 2020-21 collections.[10]

Option D achieves a flat individual income tax rate of 5.1 percent while making no changes to the corporate income tax or the sales tax.

Option E

If policymakers want to improve *both* Wisconsin's individual and corporate income tax rates without relying on offsetting sales tax changes, Option E presents one way of doing so. Like Option D, Option E achieves a net tax cut of approximately $1.2 billion without increasing the sales tax rate or broadening the sales tax base. Option E trims the corporate income tax rate to 7 percent and trims each of Wisconsin's four marginal individual income tax rates while retaining the current graduated-rate structure.

While this approach would not improve the state's tax competitiveness as much as Options A through D would, Option E is nevertheless a step in the right direction and could be enacted along with tax triggers that dedicate a certain amount of future revenue growth to reducing the top marginal individual income tax rate, consolidating four brackets into one, and reducing the corporate income tax rate, similar to the ongoing reforms in Iowa.

A downside of this approach is that it would take longer for Wisconsin to achieve truly competitive income tax rates, but even so, making incremental improvements is far better than standing still as other states continue to outcompete Wisconsin. Several notable states, such as North Carolina, Indiana, and most recently Iowa, have made remarkable structural improvements by phasing in pro-growth reforms over time.

Tax Changes Included in All or Several Options

In addition to the provisions described above that are unique to each of the five sample comprehensive tax reform options, the following policy changes are included in all or several options, and their revenue effects were accounted for when calculating the amount by which rates could be reduced. Each of the following structural changes would make Wisconsin's tax code simpler and more neutral.

9 Deneen Smith, "State Expects $3.8 Billion Surplus."

10 Wisconsin Department of Revenue, "Wisconsin Economic Forecast Update: February 2022," https://www.revenue.wi.gov/dorreports/2022-02-wi-forecast.pdf.

Increase the Standard Deduction – Options A, B, C, D, and E

Wisconsin's current sliding scale standard deduction is income-tested, with the amount taxpayers are eligible to claim decreasing as income increases. In tax year 2022, the maximum standard deduction a single filer can claim is $11,790. That amount phases down for single filers with Wisconsin income exceeding $16,990 and reaches zero for taxpayers with income exceeding $115,240.[11] The maximum standard deduction for married couples filing jointly is $21,820, and that amount phases down for those with income exceeding $24,520, phasing down to zero at $134,845 in Wisconsin income.

To provide targeted tax relief to those at the lower end of the income spectrum, all sample tax reform options increase both the maximum standard deduction and the amount of income at which the deduction phases down. Specifically, the single filer standard deduction and phaseout thresholds are each increased by $5,000, such that the maximum single filer deduction is $16,790, the phaseout begins at $21,990 in income, and the deduction phases out to zero at $120,240 in income. The standard deduction for other filers is increased by a proportionate amount as shown in Table 4.

TABLE 4.

Proposed Increase to Sliding Scale Standard Deduction

	Single		MFJ		Head of Household		Married Filing Separately	
	Current	Proposed	Current	Proposed	Current	Proposed	Current	Proposed
Maximum deduction amount	$11,790	$16,790	$21,820	$31,074	$15,230	$21,689	$10,370	$14,768
Beginning of phasedown	$16,990	$21,990	$24,520	$31,736	$16,990	$21,990	$11,640	$15,066
Phaseout to zero	$115,240	$120,240	$134,845	$140,696	$115,240	$120,240	$64,072	$66,852

Sources: Wisconsin Department of Revenue; Tax Foundation calculations.

Repeal the Economic Development Surcharge – Options A, B, C, and E

In addition to corporate or individual income tax liability, C corporations and S corporations with gross receipts of $4 million or more must pay an economic development surcharge.[12] For C corporations, the surcharge is 3 percent of Wisconsin gross tax liability, with a minimum tax of $25 and a maximum tax of $9,800. Revenue from this tax is earmarked to fund the Wisconsin Economic Development Corporation (WEDC). Compared to the current surcharge that is only levied on select businesses, the general fund would be a more neutral and stable source of revenue for the WEDC. As such, each of the options that reduce the corporate income tax rate also repeal the economic development surcharge and instead finance the WEDC through the general fund.

11 Wisconsin Department of Revenue, "Form 1 Instructions," https://www.revenue.wi.gov/TaxForms2021/2021-Form1-Inst.pdf.

12 Wisconsin Department of Revenue, "Economic Development Surcharge," accessed June 15, 2022, https://www.revenue.wi.gov/Pages/FAQS/pcs-temp.aspx#rec1.

Repeal the Throwback Rule – Options A, B, C, and E

The throwback rule in Wisconsin's corporate income tax code taxes the "nowhere income" of Wisconsin-based corporations. This reduces Wisconsin's tax competitiveness, adds unnecessary complexity, and creates the potential for double taxation. Repealing the throwback rule would make Wisconsin more attractive to prospective employers, enhancing Wisconsin's future growth prospects. Each of the options that reduce the corporate income tax rate also repeal the throwback rule (Options A, B, C, and E).

Repeal the Tangible Personal Property Tax – Options A, B, C, D, and E

While commendable progress has been made to reduce reliance on tangible personal property taxes over time, some property remains taxable, such as office furniture, fixtures, and equipment, as well as boats and other watercraft. Wisconsin policymakers have already set aside revenue to repeal this tax, but the tax will continue to be collected until lawmakers enact legislation removing it from the books.

Additional Tax Reform Considerations

Although not included in these plans, policymakers may also wish to reevaluate the married couple credit, which is designed to reduce—but not eliminate—the marriage penalty in Wisconsin's tax code.

A flat individual income tax rate eliminates one of the two sources of the marriage penalty in Wisconsin's tax code. The other contributor to the marriage penalty is the sliding scale standard deduction, which does not double for married filers. Based on data availability, our options scale up the standard deduction proportionately for all filers, maintaining progressivity in the tax code while implementing a single-rate tax. Given that the flat rates in Options A, B, C, and D will eliminate the marriage penalty in Wisconsin's individual income tax brackets, policymakers could reduce the size of the married couple credit. Still better, policymakers could also explore eliminating the marriage penalty within the standard deduction, which would allow them to repeal the credit outright and provide greater equity for married filers than is available under the existing system.

Rebalancing Revenue Sources to Promote Economic Growth

When levying taxes to fund government services, some amount of economic drag is inevitable; this is a basic reality of taxation. But not all taxes are equal; some taxes are much more economically harmful and distortive than others. As such, tax structure matters greatly and can have a tremendous impact on a state's economic well-being.

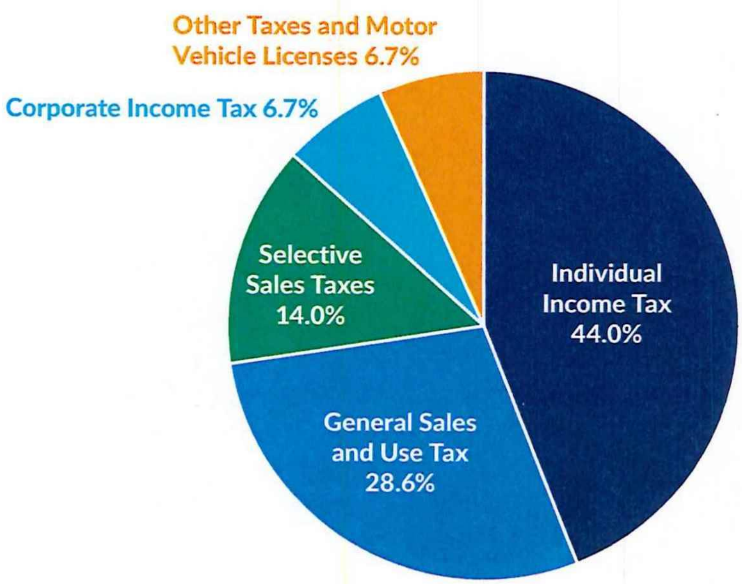
Policymakers often talk at length about *how much* revenue is raised, but the question of *how* that revenue is raised is just as important. Policymakers should always be on the lookout for ways to minimize economic harm and maintain a competitive, structurally sound tax code that allows all individuals and businesses the opportunity to thrive.

Economic research overwhelmingly finds corporate and individual income taxes to be more harmful to economic growth than well-structured sales and property taxes. Currently, however, compared to the nation as a whole, Wisconsin over-relies on more harmful taxes and under-relies on less harmful taxes.

Specifically, in fiscal year 2018-19, the most recent year of data available, 28.6 percent of Wisconsin's state and local tax collections came from individual income taxes, compared to 24.1 percent of total state and local tax collections nationally. Similarly, Wisconsin generated 4.5 percent of state and local tax collections from its corporate income tax, compared to a national figure of 3.5 percent. But while 23.3 percent of total state and local tax collections nationwide came from general sales and use taxes, only 20.1 percent of Wisconsin's collections came from that tax. Looking at state tax collections only, the individual income tax is far and away the largest revenue source, generating $8.7 billion, or 43.7 percent of state tax collections, in FY 2018-29, compared to only 28.4 percent generated by the general sales tax.

FIGURE 3.

Sources of Wisconsin's State Tax Collections



Note: The Selective Sales Taxes category includes alcohol, tobacco, fuel, and utility taxes.
Source: U.S. Census Bureau, 2019 Annual Survey of State and Local Government Finance.

Aided by a strong budget surplus and projected continued revenue growth, Wisconsin has an opportunity to rebalance its tax structure—even without reducing government spending—to better promote long-term economic growth and opportunity in the Badger State. The following pages explain how various reforms proposed in the sample tax reform options would improve the state's tax structure and competitiveness.

Corporate Income Taxes

Wisconsin's Corporate Income Tax Rate Is Among the Highest in the Nation

While the profits of pass-through businesses are taxed at the individual level instead of the entity level, the profits of C corporations are double taxed. C corporations are taxed first at the entity level (where the corporate income tax rate is applied) and again at the shareholder level, when individual shareholders pay individual income taxes on dividends received.

As of July 1, 2022, Wisconsin's corporate income tax rate of 7.9 percent is higher than the top rates in all but 12 states and the District of Columbia.[13] One of those 12 states—neighboring Iowa—is on track to grow substantially more competitive under recent reforms that will broaden the corporate income tax base while reducing the rate from 9.8 to 5.5 percent over time as specified revenue targets are met.[14]

Taxes matter to businesses, and numerous economic studies show corporate income taxes are among the most harmful to economic growth. In a comprehensive review of international econometric tax studies, Arnold et al. (2011) found corporate income taxes to be the most detrimental to economic growth, followed by individual income taxes, while finding consumption and property taxes to be less economically harmful.[15] Among the major taxes levied by state and local governments, Harden and Hoyt (2002) found the corporate income tax has the most significant negative impact on the rate of growth in employment.[16] Newman (1982) found corporate income tax differentials to be a major factor influencing businesses' moves to Southern states.[17] Agostini and Tulayasathien (2001) found a state's corporate income tax rate to be the most relevant tax to foreign direct investors deciding where to invest.

Lower Income Tax Rates Reduce the Need for Business Tax Incentives

To attract certain forms of business investment despite high income tax rates, Wisconsin's tax code offers special tax breaks for legacy industries like manufacturing and agriculture. Separately, policymakers have offered hefty tax incentives to lure specific firms to the state in exchange for their agreeing to meet certain investment and hiring targets. But Wisconsinites have seen firsthand how not all business investment and hiring goals pan out as desired, and how a great deal of deadweight loss can occur when government and business leaders rely too heavily on specific investments to drive job growth and economic opportunity in their state.

Furthermore, while incentives can substantially reduce and in some cases wipe out some forms of tax liability for some firms, they do nothing to help businesses in other sectors. This unequal treatment hinders diversified investment in Wisconsin, shifting a disproportionate share of the burden to non-qualifying firms.

13 Janelle Fritts, "State Corporate Income Tax Rates and Brackets for 2022," Tax Foundation, Jan. 18, 2022, https://www.taxfoundation.org/publications/state-corporate-income-tax-rates-and-brackets/.

14 Jared Walczak, "Iowa Enacts Sweeping Tax Reform."

15 Jens Arnold, Bert Brys, Christopher Heady, Åsa Johannsson, Cyrille Schwellnus, and Laura Vartia, "Tax Policy for Economic Recovery and Growth," *The Economic Journal* 121:550 (February 2011).

16 J. William Harden and William H. Hoyt, "Do States Choose their Mix of Taxes to Minimize Employment Losses?" *National Tax Journal* 56 (March 2003), 7-26.

17 Robert J. Newman, "Industry Migration and Growth in the South," *The Review of Economics and Statistics* 65:1 (February 1983). 76-86.

If a state has to resort to large and frequent tax incentives to attract business investment, that is a sign of an uncompetitive underlying tax code. Instead of relying heavily on incentives to smooth the roughest edges of the tax code, a simpler, more efficient, and more neutral approach would be to create and maintain a tax code that avoids disincentivizing labor and investment in the first place, regardless of industry sector or how long a business has operated in the state.

Corporate Income Taxes Fall on Workers, Consumers, and Investors

It is also important to remember that while corporations are legally responsible for paying the corporate income tax, the economic burden of the corporate income tax falls on workers in the form of lower wages, on consumers in the form of higher prices, and on investors in the form of lower returns.[18] As such, everyone is affected by corporate income taxes, even if not aware of it.

Corporate Income Taxes Are a Volatile Source of Revenue

Another reason many states have reduced reliance on corporate income taxes in recent years is because they are a highly volatile revenue source. During economic contractions, nearly all revenue streams see collections decline, but property and sales tax collections can only decline so much, while business income can drop substantially, with businesses experiencing net losses rather than profits both during economic contractions and during ordinary business cycle fluctuations.

Relying on unstable revenue sources does a disservice not just to the state but also to those who rely on government programs, as revenue shortfalls may lead to budget cuts during periods of economic hardship. Policymakers should strive to maintain a tax system that minimizes economic harms while generating a stable source of revenue. Heavy reliance on corporate income taxes interferes with both objectives.

Reducing the Corporate Income Tax Rate Would Help Wisconsin Compete Regionally and Nationally

In an increasingly competitive environment, Wisconsin's high corporate income tax rate is making the state an outlier. In 2021 alone, seven states enacted laws to reduce their corporate income tax rates: Arkansas, Idaho, Louisiana, Nebraska, New Hampshire, North Carolina, and Oklahoma. In 2022, Idaho, Nebraska, and New Hampshire enacted additional laws to reduce their rates even further, and Iowa and Utah joined the list of states enacting reductions. 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 enactment of Wisconsin's corporate income tax in 1911 has the rate been reduced. If Wisconsin policymakers want to create a competitive tax code that minimizes economic harm, reducing the corporate income tax rate ought to be a priority.

18 Erica York, "New OECD Study Quantifies Crucial Role of Businesses in the Tax System," Tax Foundation, Jan. 9, 2018, https://www.taxfoundation.org/oecd-study-quantifies-business-role-tax-system/.

Wisconsin's Throwback Rule Hurts In-State Businesses

Several of our sample tax reform options propose repealing the throwback rule, another uncompetitive feature of Wisconsin's corporate tax code. The throwback rule exposes income from Wisconsin-based outbound sales to Wisconsin's high corporate income tax rate if that income is not taxable in the destination state. As of January 1, 2023, Wisconsin will be one of only 18 states plus the District of Columbia with a throwback rule, where "nowhere income" is included in the numerator of the sales factor of the apportionment formula (thereby treating "nowhere income" sales as if they had been made into Wisconsin). Two other states use a less aggressive throwout rule, where "nowhere income" is subtracted from the denominator of the sales factor of the apportionment formula, thereby excluding sales that generate "nowhere income" from the calculation of "sales made everywhere."

Under federal laws governing interstate taxation, the income of a multistate corporation is apportioned among the states in which it operates to determine the share of the firm's income each state has legal authority to tax (known as "nexus"). Generally, a state can tax a corporation's income only when the corporation has some sort of physical presence, either property or employees, in the state. Each state has broad discretion, however, to establish its own apportionment formula based on some combination of the corporation's property, payroll, and/or sales in the taxing state.

Under Wisconsin's single sales factor apportionment formula, firms that have nexus in Wisconsin are subject to Wisconsin's corporate income tax based solely on the sales they make into Wisconsin as a share of sales made into all states.[19] Unlike formulas that take property or payroll into account, single sales factor apportionment avoids directly increasing Wisconsin corporate income tax liability based on the extent to which a firm locates its facilities or employees in Wisconsin. This apportionment formula therefore tends to favor firms that have facilities or employees in Wisconsin but sell primarily into other states, as most states' corporate income tax rates are lower than Wisconsin's.

Efforts to mitigate in-state firms' exposure to Wisconsin's high corporate income tax rate through single sales factor apportionment are countered, however, by the state's throwback rule, which substantially increases tax liability for Wisconsin-based firms that sell into states with which they have no nexus.

Given the prevalence of e-commerce in today's economy, it is common for firms to make sales into states where they do not have property or employees. Similarly, many manufacturing businesses may have out-of-state customer bases—including retailers—who pick up merchandise in Wisconsin or otherwise facilitate sales that do not establish out-of-state nexus for a Wisconsin company. These sales generate "nowhere income," income that is taxed by the federal government but is not taxable in any state. Wisconsin's throwback rule requires in-state firms to report their nowhere income to Wisconsin so it can be "thrown back" into Wisconsin's corporate income tax base and taxed at the 7.9 percent rate despite that income not being attributable to sales made into Wisconsin.

19 For some interstate firms, like pipelines and telecommunications companies, Wisconsin includes property or payroll factors in the apportionment formula.

This can increase in-state corporate income tax liability to such an extent that some firms go out of their way to avoid originating sales from states with throwback rules.[20] In some cases, firms' efforts to avoid exposure to throwback rules cost states *more* revenue on net than they gain from taxing nowhere income in the first place, given the extent to which firms avoid originating sales from states with throwback rules.[21] But not all businesses have the flexibility to plan their business activities around the tax code, so some firms are exposed to especially high effective state corporate income tax rates because of this rule.

Throwback rules were originally created to mitigate the perceived problem of less than 100 percent taxability of corporate income, but they instead create a complex system that can expose *more* than 100 percent of a firm's income to taxation, while distorting business decisions and driving some firms out of state.[22] Given these negative effects, several states have repealed their throwback rules in recent years, including Missouri in 2020 and Alabama and West Virginia in 2021. Vermont's 2022 repeal of its throwback rule will take effect January 1, 2023, and lawmakers in Louisiana are also seriously considering repeal.

Repealing Wisconsin's throwback rule would result in a modest reduction in corporate income tax collections in the near term, but it would create a substantially more competitive environment in the long run, attracting new investment and promoting stronger economic and revenue growth over time. The surplus revenue Wisconsin has brought in in recent years can help offset temporary transition costs associated with repealing the throwback rule.

Individual Income Taxes

Wisconsin's Individual Income Tax Rate Is Among the Highest in the Nation

As with corporate income taxes, Wisconsin relies especially heavily on individual income taxes. Wisconsin's graduated-rate individual income tax structure has four brackets with a top marginal rate of 7.65 percent, higher than the top marginal rates in all but eight states and the District of Columbia.

High individual income tax rates reduce returns to labor, putting a damper on hours worked and workforce participation rates. High individual income tax rates also affect Wisconsin's businesses, 95 percent of which are structured as pass-throughs, where business profits "pass through" to the owners' individual income tax forms. In Wisconsin, sole proprietorships, partnerships, limited liability companies (LLCs), and S corporations are all taxed under the individual income tax code rather than the corporate income tax code. Approximately two-thirds of pass-through business income is exposed to the 7.65 percent rate. High tax rates mean business owners have less money to reinvest in their businesses, and this results in less hiring, less capital investment, and less economic output.

20 Vernon B. Savoie and Michael L. Burr, "The Throwback Rule: Concepts, Components, and Planning Opportunities," *Journal of State Taxation* 2:19 (1983-1984), 33.

21 Jared Walczak, "Throwback and Throwout Rules: A Primer," Tax Foundation, July 2, 2019, 15, https://www.taxfoundation.org/state-throwback-rules-throwout-rules/.

22 Jared Walczak, "Throwback and Throwout Rules: A Primer," 16.

Recent Reductions to the Three Lowest Rates

In recent years, Wisconsin's lower marginal individual income tax rates have been reduced on several occasions, with reductions occurring in 2019, 2020, and 2021 that have provided permanent tax relief to low- and middle-income taxpayers. These rate changes are shown in Table 5 and are described below.

TABLE 5.

Wisconsin's Individual Income Tax Rate Schedule

Tax Years 2018-2022

	Single			Married Filing Jointly		
2022						
	3.54%	>	$0	3.54%	>	$0
	4.65%	>	$12,760	4.65%	>	$17,010
	5.30%	>	$25,520	5.30%	>	$34,030
	7.65%	>	$280,950	7.65%	>	$374,600
2021						
	3.54%	>	$0	3.54%	>	$0
	4.65%	>	$12,120	4.65%	>	$16,160
RATE REDUCTION →	5.30%	>	$24,250	5.30%	>	$32,330
	7.65%	>	$266,930	7.65%	>	$355,910
2020						
RATE REDUCTION →	3.54%	>	$0	3.54%	>	$0
RATE REDUCTION →	4.65%	>	$11,970	4.65%	>	$15,960
	6.27%	>	$23,930	6.27%	>	$31,910
	7.65%	>	$263,480	7.65%	>	$351,310
2019						
RATE REDUCTION →	3.86%	>	$0	3.86%	>	$0
RATE REDUCTION →	5.04%	>	$11,760	5.04%	>	$15,680
	6.27%	>	$23,520	6.27%	>	$31,360
	7.65%	>	$258,950	7.65%	>	$345,270
2018						
	4.00%	>	$0	4.00%	>	$0
	5.84%	>	$11,450	5.84%	>	$15,270
	6.27%	>	$22,900	6.27%	>	$30,540
	7.65%	>	$252,150	7.65%	>	$336,200

Source: Wisconsin Department of Revenue.

On July 3, 2019, Gov. Tony Evers (D) approved with partial vetoes A.B. 56 (Act 9), the biennial budget for fiscal years (FYs) 2019-21. One of the approved provisions was a reduction to Wisconsin's second-lowest individual income tax rate, lowering it from 5.84 to 5.21 percent, retroactive to January 1, 2019.

A separate bill enacted that same day, A.B. 251 (Act 10), prescribed a reduction to Wisconsin's first two marginal individual income tax rates to offset the influx in online sales tax revenue attributable to the state's response to the U.S. Supreme Court's decision in *South Dakota v. Wayfair*. Specifically, Act 10 directed the Wisconsin Department of Revenue to reduce the first two marginal rates for tax year 2019 based on the actual influx in sales tax collections between Oct. 1, 2018, and Sept. 30, 2019, that was attributable to increased collections from remote sellers post-*Wayfair*.

Act 10 further specified that for tax year 2020, the amount of actual *Wayfair*-related sales tax revenue collected between Oct. 1, 2019, and Sept. 30, 2020, would be used to determine the first two marginal rates for 2020, and that those 2020 rates would be permanent. As a result, the interaction between Act 9 and Act 10 resulted in Wisconsin's two lowest rates being reduced in both 2019 and 2020. The lowest marginal rate was reduced from 4.0 to 3.86 to 3.54 percent, and the second-lowest rate was reduced from 5.84 to 5.04 to 4.65 percent.

Two years later, on July 8, 2021, the governor approved with partial vetoes A.B. 68 (Act 58), the biennial budget for FYs 2021-23. One of the approved provisions was a reduction to the second-highest individual income tax rate, lowering it from 6.27 to 5.3 percent. This change was effective retroactive to Jan. 1, 2021.

Prior to this reduction, Wisconsin's second-highest individual income tax rate was higher than the *top* marginal rates in more than half the states that levy an individual income tax.[23] Most Wisconsin taxpayers benefited from this reduction, as it affected single filers with just over $24,000 in taxable income and married couples with just over $32,000 in taxable income.

The Importance of Reducing the Top Marginal Individual Income Tax Rate

Since 2019, the only rate that has been left unchanged, then, is the one that has the most detrimental impact on labor and investment in Wisconsin: the top marginal rate. Wisconsin's top marginal rate has stood at 7.65 percent since 2013, when it was reduced slightly from 7.75 percent.[24] At 7.65 percent, Wisconsin's top rate is higher than the top rates in all but eight states and the District of Columbia.[25] Soon, only seven states and D.C. will have a higher top rate, as Iowa's top marginal rate is set to decrease from 8.53 percent in 2022 to 6 percent in 2023, with further reductions scheduled each year until a flat rate of 3.9 percent is achieved in 2026.[26] Iowa's progress is especially remarkable given the top rate was 8.98 percent (with a state deduction for federal taxes paid) as recently as 2018.

From an economic growth standpoint, the top marginal rate is the most important rate for policymakers to reduce because it has a far greater negative impact on economic growth than do the lower marginal rates. Personal and business decisions about labor, relocation, and investment are made on the margin—that is, based on how taxes will affect the *next* dollar of income, not previous dollars of income. Under Wisconsin's current system, the top marginal rate of 7.65 percent is 2.35

23 Timothy Vermeer and Katherine Loughead, "State Individual Income Tax Rates and Brackets for 2022."

24 Dan Spika, "Individual Income Tax: Informational Paper #2," Wisconsin Legislative Fiscal Bureau, January 2021, 31, https://docs.legis.wisconsin.gov/misc/lfb/informational_papers/january_2021/0002_individual_income_tax_informational_paper_2.pdf.

25 Timothy Vermeer and Katherine Loughead, "State Individual Income Tax Rates and Brackets for 2022."

26 Jared Walczak, "Iowa Enacts Sweeping Tax Reform."

percentage points higher than the next-highest rate of 5.3 percent, meaning taxpayers with income exposed to the top rate see a significant reduction to the benefit they receive from engaging in additional work. When the marginal benefit of additional labor is reduced, taxpayers work fewer hours, and some withdraw from the workforce altogether. This reduces economic output over time.

Reductions to top marginal individual income tax rates have been shown to encourage productivity and promote long-term economic growth, while increases to top marginal rates hurt economic growth. In a study of state tax changes from 1969 to 1986, Mullen and Williams (1994) found higher marginal rates reduce gross state product growth, even after adjusting for overall state tax burdens.[27]

In a review of the economic literature surrounding graduated-rate individual income taxes, Tax Foundation's Timothy Vermeer analyzes several studies showing reductions to income tax rates lead to increases in wages, hours worked, and economic output, as well as decreases in unemployment rates.[28]

Specifically, Mertens and Olea (2013, updated 2017) found marginal individual income tax rate reductions led to an increase in the aggregate number of hours worked due to the employment of those who had previously been unemployed and an increase in the number of hours worked by those already employed.[29] They also found a negative relationship between changes in income tax rates and the wages of both higher-income and lower-income workers. Further, the authors found non-wage income to be responsive to tax rate changes, including pass-through business income, rents, interest and dividend income, and realized capital gains. Mertens and Ravn (2013) found reductions in average individual income tax rates have a positive effect on real GDP per capita and led to increases in durable goods consumption and private sector investment.[30]

Mertens and Olea (2013, 2017) found a notable distinction between the effects on economic activity of reductions to average tax rates (defined as "federal personal current taxes and contributions for social insurance...divided by total market income") and marginal tax rates. Specifically, they found reductions to marginal rates lead to nearly proportional increases in income even when the average tax rate remains unchanged. This study helps explain why reducing marginal tax rates—especially the top marginal rate—tends to be more economically beneficial than reducing income tax liability through other means, such as by carving out large portions of the tax base through various exemptions and credits. To individuals and businesses making labor and investment decisions, tax rates send a far more visible signal than base provisions as to the relative attractiveness of a state's tax environment. For example, Iowa's elimination of its state deduction for federal taxes paid is freeing up revenue for the state to reduce rates dramatically, which will reduce the "sticker shock" to prospective taxpayers of the tax costs of working or doing business in Iowa.

When considering reductions to Wisconsin's top marginal individual income tax rate, it is important to keep in mind that Wisconsin's high top rate directly affects more than just the wealthy; it affects

27 John K. Mullen and Martin Williams, "Marginal Tax Rates and State Economic Growth," *Regional Science and Urban Economics* 24:6 (December 1994).

28 Timothy Vermeer, "The Impact of Individual Income Tax Changes on Economic Growth," Tax Foundation, June 14, 2022, https://www.taxfoundation.org/income-taxes-affect-economy/.

29 Karel Mertens and Jose L. Montiel Olea, "Marginal Tax Rates and Income: New Time Series Evidence," *Quarterly Journal of Economics* 133:4 (2018), 1803-1884.

30 Karel Mertens and Morten O. Ravn, "The Dynamic Effects of Personal and Corporate Income Tax Changes in the United States," *American Economic Review* 103:4 (2013), 1212-47.

Wisconsin's small businesses as well. Approximately 95 percent of all businesses in Wisconsin are structured as pass-throughs, where business income is taxed under the individual income tax code rather than the corporate income tax code.[31]

Many people think of pass-through businesses as small businesses, but most C corporations are small businesses as well. In fact, 99 percent of all Wisconsin businesses—including pass-throughs as well as C corporations—meet the U.S. Small Business Administration's definition of a small business.[32]

In tax year 2019, 75 percent of Wisconsin pass-through business income was reported on tax returns with more than $200,000 in adjusted gross income (AGI), and 55 percent of Wisconsin pass-through business income was reported on returns with more than $500,000 in AGI.[33] Under Wisconsin's rate schedules (for single, joint, and head of household filers), we estimate that 67 percent of pass-through business income is subject to the top marginal rate, a high 7.65 percent tax on entrepreneurial activity.

Reductions to Wisconsin's top marginal individual income tax rate would be a game changer for many of the state's small businesses, yielding positive effects on entrepreneurship, business investment, and job growth for years to come.

Economic research also shows the benefits of reductions to the top rate affect more than just those whose income tax liability is directly reduced. Those rate reductions benefit those with lower incomes, as well, through positive effects on wages, employment, and overall economic conditions. Mertens and Olea (2013, updated 2017) found a cut to the average marginal tax rate that applies only to the top 1 percent of the income distribution would increase real GDP, reduce unemployment, and have a positive effect on the incomes of those not in the top 1 percent of the income distribution.[34]

While reducing Wisconsin's top marginal individual income tax rate would yield benefits for the state and its taxpayers, an even better option would be for the state to consolidate its four brackets into one while dedicating future revenue growth to rate reductions over time. The following section highlights the benefits of moving from a graduated-rate to a single-rate individual income tax structure.

States are Trending Toward Flat Taxes

In 1912, Wisconsin became the first state to implement a workable income tax after many states had tried and failed. First collected in 1912 based on 1911 income,[35] Wisconsin's individual income tax originally had 13 brackets and a top rate of 6 percent.[36] Five years later, Massachusetts implemented the nation's first single-rate individual income tax.[37]

31 Internal Revenue Service, "SOI Tax Stats - State Data FY 2021," https://www.irs.gov/statistics/soi-tax-stats-state-data-fy-2021, and "SOI Tax Stats - Historic Table 2," Tax Year 2019, https://www.irs.gov/statistics/soi-tax-stats-historic-table-2.

32 U.S. Small Business Administration Office of Advocacy, "2021 Small Business Profile: Wisconsin," https://cdn.advocacy.sba.gov/wp-content/uploads/2021/08/30143729/Small-Business-Economic-Profile-WI.pdf.

33 Internal Revenue Service, "Individual Income and Tax Data, by State and Size of Adjusted Gross Income," Statistics of Income, Tax Year 2019, https://www.irs.gov/statistics/soi-tax-stats-historic-table-2.

34 Karel Mertens and Jose L. Montiel Olea, "Marginal Tax Rates and Income: New Time Series Evidence," 1803-1884.

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

36 Wisconsin Department of Revenue, "Wisconsin Individual Income Tax: A Primer Prepared for Wisconsin Legislative Council Symposia Series on State Income Tax Reform Information," https://docs.legis.wisconsin.gov/misc/lc/study/2012/symposia_series_on_state_income_tax_reform_information/020_july_25_2012_meeting/july25koskinen.

37 Jared Walczak, "States Inaugurate a Flat Tax Revolution," Tax Foundation, Apr. 26, 2022, https://www.taxfoundation.org/flat-tax-state-income-tax-reform/.

While many states made changes to their rates and brackets in the decades to follow, no state converted its graduated-rate tax into a single-rate structure until 75 years of state income taxation had passed and all the broad-based state individual income taxes that currently exist already had been enacted.[38]

In 1987, Colorado became the first and only state during the 20th century to shift from a graduated-rate to a single-rate structure. It was followed by Utah in 2007, North Carolina in 2014, and Kentucky in 2019. While it took more than a century for the first four states to make that shift, 2022 alone brought a wave of four more states enacting laws or receiving court clearance to make that transition.[39]

Specifically, Iowa policymakers enacted a law to phase in a flat rate of 3.9 percent by 2026. Mississippi will have a flat rate of 5 percent in 2023, which is scheduled to be reduced to 4 percent by 2026. Georgia will have a flat rate of 5.49 percent in 2024, and the rate is scheduled to phase down to 4.99 percent over time. Finally, a court in Arizona cleared the path for the implementation of a 2021 law that, contingent upon revenue meeting specified targets, will phase in a flat tax at a rate of 2.5 percent as early as 2024.[40] Oklahoma is another state that gave serious consideration to flat tax legislation in 2022.

A Flat Tax Structure Would Benefit Wisconsin and Its Taxpayers

Moving to a single-rate structure would yield many benefits for Wisconsin and its taxpayers, the most notable being that single-rate structures are better than graduated-rate structures at promoting growth-inducing economic activities. Wisconsin's current graduated-rate structure imposes steep penalties on additional labor and investment on the margin, reducing the value to Wisconsinites of working additional hours, finding a higher-paying job, or making additional income-generating investments. Alternatively, under a flat tax structure, Wisconsinites would bring home the same amount of income for every dollar of taxable income earned, whether their first dollar of taxable income, their latest dollar of income, or any future dollars of income. This approach is far more neutral and pro-growth, and it creates an environment that is much friendlier to innovation and upward mobility.

The economic literature on progressive tax structures shows they have a negative effect on upward mobility and wage growth. Gentry and Hubbard (2002) found a statistically significant relationship between decreases in the progressivity of individual income tax structures and the probability of workers transitioning to a better job within a year.[41] They also found a statistically significant negative relationship between tax progressivity and the real growth rate of wages.

In addition to the economic benefits, single-rate structures better embody the principles of sound tax policy, including simplicity, transparency, and neutrality. Because all income-tax payers would be affected by a rate change, policymakers would likely work harder to justify any proposed rate

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

39 Jared Walczak, "States Inaugurate a Flat Tax Revolution."

40 Timothy Vermeer, "The Aftermath of Arizona's Proposition 208 and the Potential for a Flat Tax," Tax Foundation, Apr. 29, 2022, https://www.taxfoundation.org/arizona-flat-tax/, and Katherine Loughead, "What's in Arizona's Tax Reform Package?" Tax Foundation, July 1, 2021, https://www.taxfoundation.org/arizona-tax-reform/.

41 William M. Gentry and R. Glenn Hubbard, "The Effects Of Progressive Income Taxation On Job Turnover," *Journal of Public Economics* 88:9 (2002), 2301-2322.

increase, as it would affect a larger share of their constituents. Over time, this can help stave off unnecessary tax increases and promote the more efficient stewardship of taxpayers' resources.

Taxpayers seem to recognize this intuitively. In November 2020, Illinois voters soundly rejected a proposed constitutional amendment that would have permitted a graduated-rate structure even though the initial rates proactively passed by the General Assembly would have kept them at or below 4.95 percent for the first $250,000 in taxable income.[42] Voters seemed to understand that if a graduated-rate structure were adopted, future rate increases would become more likely.[43]

Flat taxes are also simpler and better enhance government transparency. Under a single-rate structure, taxpayers can quickly estimate their effective state income tax rate without so much as a calculator, and they can more easily estimate the extent to which a proposed rate change would affect them. Under a graduated-rate structure, however, effective tax rates are more easily disguised. Very few taxpayers have the tax rates and brackets memorized, and many, if asked, would not be able to name the rate to which their top dollar of income is exposed.

For state revenue forecasters, policymakers, and other stakeholders, a single-rate structure would also make it easier to forecast future revenue changes based on economic conditions, as well as to estimate how proposed tax policy changes would impact state revenue in the aggregate and individual taxpayers on a more granular level.

Proponents of graduated-rate income tax systems tend to view them as a way to address income inequality, but research—including a study by Feldstein and Wrobel (1998)—shows that higher marginal rates lead to a relocation of capital and higher earners to more favorable tax environments.[44] This not only undercuts the state's efforts to expose high earners to higher taxes, but also reduces the income of lower-income individuals who remain, due to reduced opportunities and a less competitive economic environment.

It is worth noting that even with a single-rate structure, Wisconsin's income tax code would contain elements of progressivity through various deductions, exemptions, and credits that exclude certain income from taxation altogether or reduce effective rates for lower-income taxpayers. These provisions include the standard deduction, as well as the refundable earned income credit and refundable homestead credit.

It is also important to remember that when it comes to questions of progressivity and equity, taxes tell only one side of the story. Even with a less progressive income tax structure, Wisconsin's tax and transfer system would continue to be progressive, given state and local spending on food and nutrition assistance programs like SNAP and WIC; affordable housing; health care, childcare, and utilities payment assistance; vocational education and training; and other income-tested programs providing financial support to lower-income individuals and families. The tax code is not always—or even often—the best way to provide income supports or other varieties of low-income assistance.

42 Jared Walczak and Katherine Loughead, "Twelve Things to Know About the 'Fair Tax for Illinois,'" Tax Foundation, Oct. 6, 2020, 3, https://www.taxfoundation.org/illinois-fair-tax/.

43 Jared Walczak, "States Inaugurate a Flat Tax Revolution."

44 Martin Feldstein and Marian V. Wrobel, "Can State Taxes Redistribute Income?" *Journal of Public Economics* 68:3 (1998), 369-96.

Currently, nine states have flat individual income tax structures, with five of those states adding another layer of protection to that status by making a flat tax structure part of their state constitutions. An additional four states have enacted laws to transition to a flat tax, for a total of 13 states that have, or are in the process of implementing, a single-rate structure.[45] Four of those states—Iowa, Illinois, Indiana, and Michigan—are Wisconsin neighbors. An additional five states—Alabama, Arkansas, Idaho, Missouri, and Oklahoma—have structures that technically are graduated but effectively are close to flat, with top rates kicking in at or below $10,000 in taxable income.

Triggers Could Continue the Work of Reform

Across the country, revenue triggers have emerged as an effective way to implement or phase in tax rate reductions or other tax reform measures as revenues permit. Tax triggers are a newer 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.[46]

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. Their ability to do so, however, depends on their design. Poorly designed triggers can implement cuts when economic conditions do not warrant it or postpone reductions even when revenue growth would permit it. By contrast, properly constructed tax triggers are a valuable mechanism for providing meaningful rate relief.

Well-designed triggers require selecting a baseline revenue figure—either a given year's revenue or a statutorily established amount—and then establishing benchmarks that reflect meaningful revenue growth. Lawmakers should not use year-over-year revenue changes but instead establish a specific revenue baseline and employ benchmarks that measure real revenue growth, adjusted for inflation, over that base year amount. Ideally, reductions should not be tied to specific years but instead triggered whenever real revenue growth is adequate to reduce rates by at least a given increment—say 10 or 25 basis points—with the actual size of the reduction based on a statutorily established proportion of inflation-adjusted revenue growth.

45 Jared Walczak, "States Inaugurate a Flat Tax Revolution."

46 Jared Walczak, "Designing Tax Triggers: Lessons from the States," Tax Foundation, Sept. 7, 2016, https://www.taxfoundation.org/designing-tax-triggers-lessons-states/.

Sales Taxes

Wisconsin's Sales Tax Rate Is Among the Lowest in the Nation

While Wisconsin's individual and corporate income tax rates are high compared to the rest of the country, its sales tax rate is among the lowest in the nation. At 5 percent, Wisconsin's state sales tax rate is well below average, and the combined state and average local sales tax rate of 5.43 percent is the third lowest in the country behind only Wyoming (5.22 percent) and Alaska, which has an average local sales tax rate of 1.76 percent but does not have a state-level sales tax.

Wisconsin's Sales Tax Base Has Room for Modernization

Wisconsin's sales tax base, the basket of goods and services to which the sales tax applies, is slightly broader than the national median, but many notable categories of consumer goods and services remain exempt that ought to be taxed. While comparing states' sales tax breadth is challenging because each state taxes a unique set of goods and services, one way to approximate sales tax breadth is to calculate the total value of taxed transactions as a percentage of total state personal income. In Wisconsin, this yields a sales tax breadth of 36.92 percent, slightly higher than the national median of 35.72 percent.[47]

Sales Taxes Are Less Economically Harmful Than Income Taxes

The economic literature on consumption taxes consistently finds they are less harmful than income taxes, especially when the sales tax is destination-based, as Wisconsin's is, and when the tax is applied to final retail consumption only, not business-to-business purchases.[48]

In a study examining the economic effects of income and consumption taxes in the United Kingdom, Nguyen, Onnis, and Rossi (2021) found income tax changes had large and persistent effects on income, consumption, and investment, while consumption taxes had only modest effects.[49] In a study on public spending, taxation, and long-term economic growth, Bleaney, Gemmell, and Kneller (2001) conclude that consumption taxes do not cause economic distortions.[50] Economists affiliated with the Organisation for Economic Co-operation and Development (OECD) found that a 1 percent shift of tax revenues away from income taxes toward consumption and property taxes would increase long-run GDP per capita by as much as 1 percent.[51] Additionally, a Canadian study found sales tax increases to be associated with increases in economic growth due to sales taxes often replacing taxes on income and investment.[52]

47 Jared Walczak, "State Sales Tax Breadth and Reliance, Fiscal Year 2021," Tax Foundation, May 4, 2022, https://www.taxfoundation.org/state-sales-tax-base-reliance/.

48 William McBride, "What Is the Evidence on Taxes and Growth?" Tax Foundation, Dec. 18, 2012, https://www.taxfoundation.org/what-evidence-taxes-and-growth/.

49 Anh D. M. Nguyen, Luisanna Onnis, and Raffaele Rossi, "The Macroeconomic Effects of Income and Consumption Tax Changes," *American Economic Journal: Economic Policy* 13:2 (2021), 439-66.

50 Michael Bleaney, Norman Gemmell, and Richard Kneller, "Testing the Endogenous Growth Model: Public Expenditure, Taxation, and Growth Over the Long Run," *Canadian Journal of Economics* 34 (2001), 36-57.

51 Åsa Johansson, Christopher Heady, Jens Arnold, Bert Brys, and Laura Vartia, "Tax and Economic Growth," OECD Economics Department Working Papers No. 620, 2008; and Jens Arnold, "Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries," OECD Economics Department Working Papers No. 643, 2008.

52 Ergete Ferede and Bev Dahlby, "The Impact of Tax Cuts on Economic Growth: Evidence from the Canadian Provinces," *National Tax Journal* 65:3 (September 2012).

A key reason sales taxes are less economically harmful is because they apply to present consumption only, whereas income taxes apply both to income that is consumed now and to income that is saved or invested to be spent later, which leads to double taxation of consumption when sales taxes are also applied.[53]

Because consumption taxes are less harmful to economic growth than are income taxes, lawmakers should consider increasing reliance on the sales tax to reduce reliance on more harmful corporate and individual income taxes. Tennessee is one example of a state that is enjoying robust economic growth and strong net inbound migration despite its high sales tax rate and larger-than-average sales tax base, as this heavy reliance on consumption taxes enables the state to completely forgo individual income taxes.

Increased Sales Tax Reliance Can Offset Income Tax Rate Reductions

Because consumption is a more neutral and less harmful tax base than income, several of the sample comprehensive tax reform options proposed in this report increase reliance on sales taxes to partially offset individual and corporate income tax rate reductions and reforms.

Policymakers can use sales tax base broadening, sales tax rate increases, or both, to offset income tax rate reductions, but of those two options, base broadening ideally would be considered first, as economists generally agree that broad-based, low-rate taxes are structurally superior to narrow-based, high-rate taxes, as they are more neutral and generate a more stable source of revenue.

Specifically, Wisconsin's sales tax base could be expanded to a variety of consumer services that have never been taxed, as well as to various consumer goods that were carved out of the sales tax base over time. Sales taxes should not, however, be newly applied to business-to-business transactions. Taxing business inputs leads to tax pyramiding, where taxes often get embedded in the prices of final goods and services multiple times over and in a nontransparent manner. Taxing business-to-business purchases is also nonneutral in that it harms some industries more than others and encourages vertical integration of supply chains to avoid the tax.

Table 6 shows a list of some of the currently untaxed consumer services and goods that could be included in the sales tax base to generate revenue to offset income tax reforms. Using data from the Wisconsin Department of Revenue's 2021 Summary of Tax Exemption Devices and the Wisconsin Legislative Fiscal Bureau's January 2022 revenues forecasts, we estimate broadening the sales tax base to the household consumption (not business-to-business purchases) of the following services would increase revenue by approximately $291 million in FY 2022-23.[54]

It is also important to keep in mind that because Wisconsin has a uniform state and local sales tax base, any expansion of the state sales tax base would extend to the local base as well, yielding increased revenue for counties.

53 Charles E. McLure Jr., "Rethinking State and Local Reliance on the Retail Sales Tax: Should We Fix the Sales Tax or Discard It?" *BYU Law Review* 2000:1 (Mar. 1, 2000), https://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?article=2052&context=lawreview.

54 Wisconsin Department of Revenue, "2021 Summary of Tax Exemption Devices," February 2021, https://www.revenue.wi.gov/dorreports/21sumrpt.pdf, and Wisconsin Legislative Fiscal Bureau, "Revenue Estimates January 25, 2022.

TABLE 6.

Sales Tax Base Broadening Options

Consumer Good or Service	Estimated Fiscal Effect (FY 2022-23)
Repair of Real Property	$72,467,355
Beauty, Barber, Nail and Other Personal Care Services	$56,233,428
Veterinary Services for Pets	$39,516,387
Accounting Services*	$21,590,317
Health Clubs	$20,439,510
Funeral Services, excluding Caskets and Vaults	$16,970,987
Dues and Fees Paid to Business Associations and Fraternal Organizations	$16,351,608
Newspapers, Periodicals, and Shoppers Guides	$13,378,589
Admissions to Educational Events and Places	$10,157,817
Disinfecting and Exterminating	$7,184,798
Interior Design*	$3,096,896
Caskets and Burial Vaults	$5,822,164
Auto and Travel Clubs	$4,707,281
Tax Preparation Services*	$3,406,585
TOTAL	**$291,323,720**

Note: The estimated fiscal effects for accounting, interior design, and tax preparation services assume the sales tax is applied only when those services are purchased by individuals, not businesses.

Sources: Wisconsin Department of Revenue, "State of Wisconsin Tax Exemption Devices, 2021-23"; Wisconsin Legislative Fiscal Bureau, "Revenue Estimates January 25, 2022"; Council on State Taxation, "Sales Taxation of Business Inputs"; author's calculations.

Broadening the sales tax base would generate additional revenue while minimizing economic harms and making the tax code more neutral in the process.

Extending the sales tax to consumer services would also capture a larger share of personal consumption expenditures that tend to be more discretionary in nature and therefore are more often purchased by higher-income consumers. This would right an accidental wrong in the tax code that currently favors higher-income consumers by leaving many of their discretionary purchases untaxed.

In addition to broadening the sales tax base, policymakers could consider raising the sales tax rate. On a static basis and assuming no other economic effects, each percentage point of Wisconsin's current 5 percent state sales tax generates approximately $1.45 billion, for a total of $7.23 billion in sales and use tax revenue expected to be collected in FY 2022-23.[55]

Large sales tax rate differentials among neighboring states can lead to cross-border shopping, but all of Wisconsin's immediate neighbors have state and average local sales tax rates in the 6 to 8 percent range, leaving plenty of room for Wisconsin to raise sales tax rates while still maintaining a rate at or below the levels of its neighbors.[56]

55 Wisconsin Legislative Fiscal Bureau, "Wisconsin Economic Forecast Update – February 2022."

56 Janelle Fritts, "State and Local Sales Tax Rates, 2022."

Property Taxes

Real Property Taxes Are a Good Local Tax Base

Like its sales tax system, Wisconsin's property tax system is relatively well structured in that its property taxes are simple and neutral in their application across different types of real property. As Wisconsinites are well aware, property taxes are indeed high in Wisconsin; homeowners face an effective property tax rate of 1.63 percent when considering property tax collections as a share of owner-occupied home value.[57] But real property is the least economically harmful of the major tax bases, so real property taxes are an appropriate source of local revenue to fund local government services.

Unlike labor or capital, real property is immobile, so tax avoidance options are limited. Real property taxes are also highly transparent and adhere well to the benefit principle in public finance that says taxes paid should relate closely with benefits received.

It is also important to note that heavier reliance on local real property taxes has enabled Wisconsin to keep the county local option sales tax rate much lower than the rates in most other states. Wisconsin counties have the option to levy a local sales tax at a rate of 0.5 percent, while the average local sales tax rate nationwide is roughly 2 percent.[58]

As a taxpayer protection mechanism, property taxes levied by Wisconsin school districts and municipal and county governments are subject to strict levy limits that essentially only permit collections to rise with voter approval.[59] These property tax caps have been effective in reducing overall property tax burdens in recent years, and they should be allowed to continue working.

The Personal Property Tax Remains Ripe for Elimination

This publication prioritizes discussion of income tax rates and related provisions that are most hindering Wisconsin's economic competitiveness, but in the course of any tax reform conversations, one area of the property tax code that policymakers should prioritize for elimination is the counterproductive tax on business (and select other) personal property, sometimes known as the tangible personal property tax.

Wisconsin has already made commendable progress in exempting large categories of tangible property from *ad valorem* taxes over time, but annual property taxes continue to be collected on the value of office furniture, fixtures, and equipment; boats and other watercraft; and certain other items.[60]

57 Janelle Fritts, *Facts and Figures 2022: How Does Your State Compare?* Table 32, Tax Foundation, Mar. 29, 2022, https://www.taxfoundation.org/publications/facts-and-figures.

58 Janelle Fritts, "State and Local Sales Tax Rates, 2022."

59 Katherine Loughead, Jared Walczak, and Joseph Bishop-Henchman, "Wisconsin Tax Options: A Guide to Fair, Simple, Pro-Growth Reform," 84.

60 Wisconsin Department of Revenue, Division of Research and Policy, "Property Tax Overview," Dec. 27, 2019, https://www.revenue.wi.gov/DORReports/ProTax.pdf.

Personal property taxes not only increase the cost of investing in Wisconsin, but they also impose substantial compliance costs, as businesses must proactively calculate the depreciable value of their taxable tangible personal property each year and remit the appropriate tax. In some cases, taxpayers expend more resources complying with this tax than they remit in tax liability, making it more of a nuisance tax than anything, and one that creates significant deadweight losses.

Since Wisconsin's property taxes are exclusively a local levy, the elimination of the personal property tax would result in reduced tax revenue for local governments. To hold local governments harmless, state policymakers could simply increase their aid to localities based on a formula that takes the current value of taxable tangible property into account and adjusts for inflation.

An approach similar to this was considered during the 2021 legislative session, when the Legislature sent a bill to the governor (A.B. 191) to repeal the personal property tax and appropriated funds in the budget to offset associated local revenue losses. Gov. Evers vetoed the personal property tax repeal legislation but did not veto the appropriation that went along with it. He then backed a separate bill (A.B. 641) to repeal the tax, but that legislation did not pass the Legislature. Given that the Legislature has already set aside revenue to offset local revenue losses, reaching an agreement to repeal the tax should remain a near-term priority.

Conclusion

While Wisconsin has made modest improvements to its individual income tax rates in recent years, the top marginal rate, the rate that matters most to the state's economic competitiveness, remains among the highest in the country. Wisconsin's corporate income tax rate is even higher, and these taxes on productivity are hurting the state's ability to attract businesses and workers to the state. Our sample comprehensive tax reform options present five ways the Badger State's tax code could be rebalanced to promote economic growth and competitiveness. Two of these reform options simply dedicate a portion of revenue growth to tax reform, while three of the options facilitate further income tax reductions by shifting additional reliance onto the sales tax, which currently has among the lowest rates in the country. Given the state's strong budget surplus and projected continued revenue growth, Wisconsin is in a prime position to enact pro-growth reforms to improve the state's competitive standing for decades to come.

ABOUT THE TAX FOUNDATION

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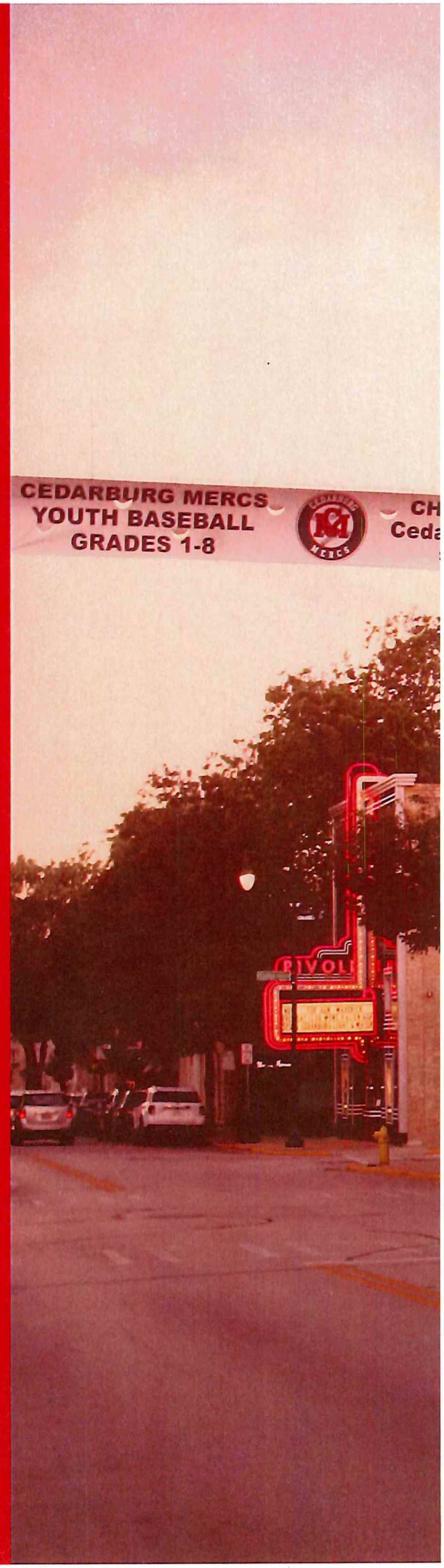
Cover image, Robert Helf.

Wisconsin has long been a high income-tax state, imposing steep tax burdens on labor and productivity. Since 2019, the Wisconsin Legislature has provided incremental relief to low- and middle-income Wisconsinites, but high corporate and top marginal individual income tax rates hinder upward mobility and impede economic growth. Meanwhile, other states are rapidly growing more competitive, with close to half the states reducing income tax rates in the past two years alone, and four states transitioning to a flat tax structure.

Fortunately, Wisconsin's strong revenue growth presents a valuable opportunity to alleviate the state's high tax burden while creating an environment that is more conducive to economic mobility and growth. This publication seeks to inform policymakers' deliberations toward that end, highlighting problem areas in Wisconsin's tax code and outlining five sample comprehensive tax reform options to help the state attract and retain good jobs and a talented workforce across a variety of industries.

The tax policy solutions presented in this report are similar to those outlined in our 2019 publication *Wisconsin Tax Options: A Guide to Fair, Simple, Pro-Growth Reform*, but they have been updated to reflect current tax collections and revenue forecasts as well as recent tax policy changes in Wisconsin and across the country.

Comprehensive tax modernization is long overdue in Wisconsin. Policymakers should take these important steps to remove barriers that impede opportunity, reshaping the tax landscape so all taxpayers have a better opportunity to flourish in the Badger State.



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