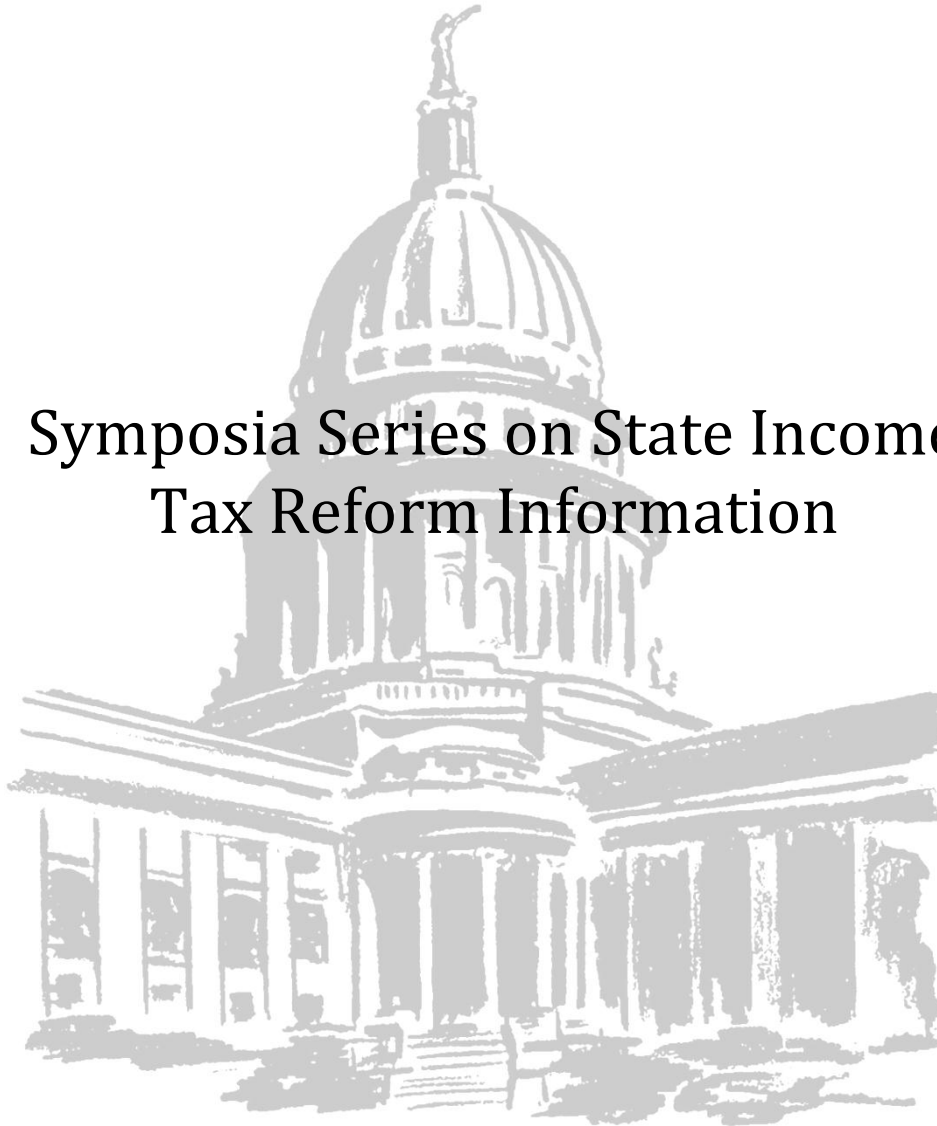


Report to the Joint Legislative Council

Symposia Series on State Income Tax Reform Information



December 13, 2012

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Wisconsin Legislative Council
One East Main Street, Suite 401
Madison, WI 53703-3382
Phone: (608) 266-1304
Fax: (608) 266-3830

www.legis.wisconsin.gov/lc

SYMPOSIA SERIES ON STATE INCOME TAX REFORM INFORMATION

Prepared by:
Scott Grosz, Senior Staff Attorney and Dan Schmidt, Senior Analyst
December 13, 2012

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PART I

STEERING COMMITTEE FORMATION AND ASSIGNMENT

In April 2012, Senator Mary Lazich and Representative Joan Ballweg, Co-Chairs of the Joint Legislative Council, created a steering committee to develop a symposia series on state income tax reform information. Chaired by Representative Robin Vos and Vice-Chaired by Representative Dale Kooyenga, the committee was provided with the following assignment:

The steering committee is directed to: conduct information symposia and develop recommendations regarding Wisconsin's income tax code. The committee shall: review Wisconsin's current income tax code, the income tax codes of other states, and previously proposed methods for state tax code reform; consider the social and economic effects of tax code reforms as applied to individual and corporate taxpayers as well as the fiscal effects on state revenues; and develop recommendations, in the form of a committee report, for income tax reform that would improve economic growth for residents and businesses in the State of Wisconsin.

PART II

COMMITTEE ACTIVITY

June 26, 2012

On June 26, 2012, the Steering Committee held a public hearing in order to define its approach to the committee assignment prescribed by the Legislative Council Co-Chairs and to discuss potential speakers on the topic of income tax reform.

July 25, 2012

On July 25, 2012, in its first symposium, the committee received invited testimony on the issue of the *status quo* as it pertains to income taxation in Wisconsin and other states.

John Koskinen, Chief Economist, Division of Research and Policy, Department of Revenue (DOR) began his presentation with a description of Wisconsin's income tax in the context of other Wisconsin taxes as well as income taxes in other states. He noted that Wisconsin's income tax accounts for slightly more than 50% of the state's general purpose revenue (GPR). On the national level, Wisconsin ranked 12th in the measure of income tax as a percent of total state tax collections. Mr. Koskinen described how Wisconsin's total income tax receipts have recovered following the recent recession. He also described the long-term trend showing an increase in income taxes as a portion of total tax collections.

Following his description of income tax collections, Mr. Koskinen provided a brief overview of the history of Wisconsin's income tax rate and bracket structure, including its creation in 1911 as well as major changes in 1979, 1986, 1999, and 2002. He then discussed Wisconsin's current rate and bracket structure, and noted how Wisconsin compared to other states in terms of top marginal rate, and rank by income class.

After describing the history of Wisconsin's income tax and its comparison to other states, Mr. Koskinen explained the process by which Wisconsin income taxes are calculated, including a description of income sources as related to a taxpayer's age as well as a description of the relationship between the calculation of federal and state income taxes. Finally, he described the most popular credits against Wisconsin income taxes, noting the approximate fiscal effect of each credit.

Following his explanation of the calculation of Wisconsin income taxes, Mr. Koskinen provided a profile of Wisconsin income taxpayers, describing statistics on types of taxpayers (e.g., single, dependent, joint) and tax rates and share of total collections as related to classes of adjusted gross income. Finally, Mr. Koskinen described the distribution effects of certain tax credits, including the school property tax/rent credit, the married couple credit, and the working families credit.

Rick Olin, Legislative Fiscal Bureau, began his presentation with an overview of the Legislative Fiscal Bureau's report, "Individual Income Tax Provisions in the States" (July 2012). As its title suggests, the report described the income tax structure of other states, including highlights of certain tax credits, the basic structure of each state's income tax system, and significant deviations from federal taxation. In particular, Mr. Olin compared the taxation of capital gains and social security among various states. The report featured analysis and comparison of the states on issues including each state's filing system, the taxation of particular types of income (social security, capital gains, interest and dividends, unemployment compensation, state and municipal bond interest, military pay, retirement income, and health savings accounts). The report also compared the states in relation to deductions, exemptions, tax rates and brackets, contributions and check-offs, and credits.

Rob Reinhardt, Legislative Fiscal Bureau, provided a comparison of revenues and expenditures in Wisconsin and other states, in terms of per capita income as well as per \$1,000 of personal income. He also reported on Wisconsin's comparison to other states with regard to total state and local taxes, state and local individual income taxes, state and local property taxes, general sales taxes, corporate income taxes, motor fuel taxes, and state and local government expenditures.

On July 30, 2012, Mr. Olin provided the committee with another report, following up on questions raised at the meeting relating to income tax liability paid by taxpayers arranged by income class. This report detailed the distribution of net tax liability by adjusted gross income classes for tax years 1985, 1990, 1995, 2000, 2005, and 2010.

September 6, 2012

At the September 6, 2012 symposia, the Steering Committee and attendees heard presentations from the following speakers:

Andrew Reschovsky, Professor of Public Affairs and Applied Economics from the LaFollette School of Public Affairs, discussed the dual roles of income taxes in Wisconsin – providing revenue and creating incentives. He indicated that any tax policy is best analyzed in the context of a balanced budget and should incorporate the tax system as a whole, rather than simply considering individual types of taxes. Dr. Reschovsky then described the components of a tax system that economists study when analyzing a tax system. These items include the efficiency of effect, the distribution of the tax burden, the administrative feasibility and the revenue growth and volatility of the tax. He stated that the legislation of tax policy often involves trade-offs between policy objectives and political positions.

Dr. Reschovsky then compared the economic theory of taxation to current empirical evidence regarding taxation. He described the complexity of the Wisconsin Income Tax System and argued for simplification, particularly in the area of tax credits. He summarized his final recommendations for policymakers by calling for an expansion of the tax base through the elimination of tax credits, aligning the Wisconsin tax base more closely to Federal Adjusted Gross Income (AGI), and ending the Wisconsin capital gains tax exclusion. Dr. Reschovsky later recommended that Wisconsin continue to perform tax incidence studies and use the data to

support a tax reform commission to study the tax system as a whole and issue recommendations based on legislative guidelines.

Todd Berry, President of the Wisconsin Taxpayers Alliance, opened his presentation with the assertion that the federal tax system has a far greater effect on economic behavior than the State tax system, largely because the amount of federal tax paid is greater. Notwithstanding that statement, he stated that the Wisconsin tax system did have a number of areas where improvement is warranted. He indicated that Wisconsin is over-reliant on property taxes and under-reliant on sales taxes for the generation of state revenue. He asserted that the current tax system in Wisconsin has placed its greatest burden on the broad middle income brackets of taxpayers.

Mr. Berry made the following recommendations when considering tax reform in Wisconsin: (1) eliminate tax credits; (2) conform to federal tax law as much as possible (including the use of federal AGI to determine tax rate); (3) make the top corporate and individual income tax rates the same; (4) update current income caps and exemptions; (5) consider an income tax system that does not require filing, but uses a withholding table as an alternative; and (6) expand the current retail sales tax system or move toward a European-style value added tax system. Mr. Berry later recommended that policymakers use the Joint Survey Committee on Tax Exemptions to vet ideas for credits and exemptions.

Matt Gardner, Executive Director for the Institute on Taxation and Economic Policy (ITEP), introduced the audience to the ITEP Microsimulation Tax Model that was designed to predict the effects of changes on taxpayers at different income levels, predict the revenue gain or loss from proposed tax changes, estimate the impact of current state and local taxes state-by-state and measure the interaction between state and federal tax law changes. He added that the model uses the same technology as the United States Treasury and the Congressional Budget Office. The ITEP Model consists of four basic modules: personal income tax, property tax, consumption tax, and business tax.

Mr. Gardner indicated that the ITEP Model demonstrates that Wisconsin taxes are generally regressive in nature, largely led by the fact that revenues are driven by sales and property taxes. He indicated that the income tax, while fairer, can be overly complicated and volatile. He further indicated that the complexity of Wisconsin's income tax lies not in its rate structure, but in its proliferation of credits, adjustments and exclusions. He added that the volatility is best mitigated by a progressive income tax which grows revenues faster than a flat tax as economies improve. Mr. Gardner then explained how income tax cuts do not necessarily lead to economic growth under the ITEP analysis. He described a number of income tax reform plans from other states including Georgia, South Carolina, Mississippi, Kansas, North Carolina, Oklahoma, Rhode Island, Utah, Maine, and others. Mr. Gardner summarized his thoughts as follows: (1) broaden the tax base first; (2) adjust tax rates second; (3) complexity is the product of tax loopholes, not rates; (4) linkage between tax rate reductions and economic development is not clear; and (5) volatility has long-term growth benefits as well as short-term reduction challenges. He later recommended that Wisconsin sunset any future tax credits to limit overspending and engage in a regular tax collection and expenditure report to fully understand where tax dollars are spent.

Joseph Henchmen, Vice President of the Tax Foundation, discussed the importance of state taxes, explaining that as the federal tax rates have decreased, state taxes have a larger effect on the taxpayers. He also stressed that the purpose of taxation must be fair and must promote economic growth, but acknowledged that such issues may be perceived differently by different audiences and perspectives. He stated that spending significantly exceeds tax income in many states, however, he acknowledged this is less of an issue in Wisconsin. Mr. Henchmen compared Wisconsin's state and local tax burden to the U.S. average from the years 1977 to 2009 and gave a number of facts and comparisons relating to corporate and individual tax rates. Mr. Henchmen concluded by recommending that Wisconsin policymakers reduce current tax incentives by comprehensively reviewing their current effectiveness toward their stated goals. He later added that this may best be accomplished by taking all incentives out of the tax law and adding back the ones which are deemed justified.

October 18, 2012

On October 18, 2012, the committee convened its third symposium to receive testimony from Michael Friedman, Henry Jasper, and Richard Kollauf, members of the Wisconsin Institute of Certified Public Accountants. Their testimony provided a description of the effects of Wisconsin income tax policy from an accountant's perspective, and also provided recommendations for tax reform. Following their testimony, John Koskinen, DOR, also presented the committee with an outline of general considerations necessary in the context of income tax reform.

Henry Jasper, C.P.A., M.S.T., Behling, Jasper & Selberg, LLC, began his presentation by explaining his background as a partner in a small, local CPA firm located in Fort Atkinson. He described his clients as small businesses and individual, with business clients ranging in size up to \$40 million in sales. Following this introduction, Mr. Jasper described the relationship between business income and individual income taxes as a result of the taxation structure applicable to sole-proprietors and pass-through entities such as S-corporations and partnerships. He noted several aspects of Wisconsin's income tax system that work well, including the use of electronic filing and refunds as well as the quality of services provided by DOR. He also cited excessive complexity as a weakness of the Wisconsin income tax system, noting the effects of long forms, numerous schedules, and complicated administration of tax credits.

Following his description of the current Wisconsin income tax system, Mr. Jasper made several recommendations for reform. He suggested conforming Wisconsin tax law more fully with federal tax law, in particular as related to depreciation deductions. He also suggested eliminating the Wisconsin alternative minimum tax (AMT) or allowing an AMT credit in order to address depreciation differences.

As another option, he outlined a complete overhaul of the Wisconsin income tax system based on federal taxable income and the application of a limited set of subtractions and add-backs as well as tax credit reform. For tax credit reform, he suggested a large-scale consolidation of credits into an investment credit, a research credit, and an employment credit, with generally applicable rules for credit administration, along with retention of the homestead credit and the Wisconsin earned income tax credit.

Michael Friedman, J.D., C.P.A., Tax Director, Scribner, Cohen and Company, S.C., began his presentation with an overview of his career and typical clients, explaining that he has over 35 years of experience, focused primarily on servicing privately held companies and their owners. His typical business clients include manufacturing, distribution, and real estate businesses with sales of between \$10 million and \$500 million. In terms of individual clients, he noted that he has been involved in numerous complex transactions relating to trust, gift, and estate planning.

Mr. Friedman next described his perceptions that Wisconsin's highest tax rates put it at a competitive disadvantage with neighboring states. Mr. Friedman also emphasized the need to simplify the Wisconsin income tax code, providing testimony on departures from federal adjusted gross income that are necessary to compute one's Wisconsin income tax liability. He also discussed his experience with various modifications and credits, noting that there are many modifications and credits claimed by only a small fraction of his clients. Similarly, Mr. Friedman offered his perspective that very few credits actually affect taxpayer behavior, and that elimination of credits in favor of lower overall rates would be recommended. Mr. Friedman also made a comprehensive series of recommendations, including more complete adoption of federal tax law, elimination of the 30% capital gain exclusion, elimination of the marriage penalty in rate tables, and elimination of many tax credits, including highly used credits, coupled with the adoption of a single, reduced tax rate for all taxpayers.

Richard Kollauf, J.D., C.P.A., Director, Vogel Consulting Group provided testimony to the committee that reiterated many of the recommendations provided by Mr. Jasper. In particular, he suggested reforming the state income tax system to follow model tax law guidelines and conform to federal tax law to the fullest extent possible; to apply laws consistently without regard to entity type; to reduce taxes to encourage economic growth; to simplify deductions and credits; and to review administrative tax rules to revise or eliminate rules that impose unreasonable burdens on taxpayers. Specific examples of these issues cited by Mr. Kollauf included conformity with the Uniform Division of Income Tax Purposes Act, the absence of S-corporation eligibility for certain investment tax credits, the compliance benefits of a flat tax rate, and the administrative rules and forms relating to combined reporting.

John Koskinen, Chief Economist, Division of Research and Policy, Department of Revenue provided testimony on strategic considerations for income tax reform. The subject of Mr. Koskinen's testimony related to a "roadmap" for income tax reform where he outlined a general description of the decisions necessary to undertake income tax reform. These decisions included the strategic choices of identifying an objective and choosing the timeframe for achieving the objective, as well as the tactical choices to identify the focal point of the objective and the policy changes necessary to achieve it. To illustrate the process he described, Mr. Koskinen identified four objectives and then provided the committee with analysis related to each objective. The four objectives were: improvement of economic competitiveness; reduction of tax burden; improvement in popular tax rankings; and simplification of the tax code.

Mr. Koskinen began his analysis with the objective of tax code simplification. Assuming a goal of revenue neutrality, he briefly described the current relationship between the Wisconsin and federal tax codes. He also identified the interest of the state policymakers to direct state policy as the source of Wisconsin's deviations from the federal code. After identifying the fiscal

effect of the largest Wisconsin tax preferences, he identified reduction of overall rates and elimination of preferences as two common consensus recommendations for tax code simplification. Finally, Mr. Koskinen provided a historical perspective on past efforts to simplify the state tax code, noting the difficulty of allocating beneficial and detrimental treatment to various groups, which is an inherent requirement of revenue-neutral reform.

Mr. Koskinen next analyzed the objectives of a reduction of the income tax burden and improvement in the state's tax rankings. He described the effects of previous reforms in 2000 and 2001, which resulted in a reduction of the income tax burden that has been sustained in the following years. He also provided information on Wisconsin's current tax rankings. Using these examples, he discussed the effects of the strategic choice relating to timing of tax reform. He noted that revenue neutral reforms may be implemented more immediately than reforms that reduce tax revenue. Mr. Koskinen also provided estimates of the magnitude of tax revenue reductions necessary to achieve objectives related to improvement of tax rankings.

Finally, Mr. Koskinen provided analysis of the focal point of "middle class" tax relief. He described the shape of the curve that represents Wisconsin's effective tax rates over various income classes, and provided an estimate of the effect of a revenue neutral flat tax rate as compared to current rates for various income classes. He also estimated the effects of various policy changes on the income tax curve including a 10% across-the-board reduction of tax rates, reduction of "middle class" tax rates, and elimination of the personal exemption.

PART III

RECOMMENDATIONS RECEIVED BY THE STEERING COMMITTEE

The following is a summary of the recommendations for consideration in reforming the Wisconsin Income Tax System, as presented by speakers in the three State Income Tax Reform Symposia:

- Consider tax reforms in the context of the entire tax system. (Reschovsky)
- Analyze tax policy changes in the context of a balanced budget. (Reschovsky)
- Examine the efficiency of effect, distribution of the tax burden, administrative feasibility, revenue growth, and volatility of proposed tax policies. (Reschovsky)
- Broaden the tax base through the elimination of tax credits. (Reschovsky, Berry, Gardner, and Henschmen)
- Simplify the tax code by eliminating or limiting tax exemptions, exclusions, and credits. (Reschovsky, Berry, Gardner, Henschmen, Jasper, Friedman, and Kollauf)
- Align the Wisconsin tax base more closely with Federal Adjusted Gross Income to determine tax rate. (Reschovsky and Berry)
- Eliminate the 30% Wisconsin capital gains exclusion and any other exclusions that are not related to a taxpayer's ability to pay. (Reschovsky and Friedman)
- Perform regular tax incidence studies and use data to continue reform over time. (Reschovsky and Gardner)
- Conform to federal tax law as much as possible. (Berry, Jasper, Friedman, and Kollauf)
- Make top corporate and individual income tax rates the same. (Berry)
- Update income caps and exemptions to reflect current economy. (Berry)
- Consider creating a tax system that does not require filing, but uses a withholding table instead. (Berry)
- Increase revenue by expanding the current sales tax system or creating a European-style Value-Added Tax system. (Berry)
- Use the Joint Survey Committee on Tax Exemptions to vet any future credits or exemptions. (Berry)
- Mitigate revenue volatility through a progressive tax system. (Gardner)

- Consider that the linkage between tax rate reductions and economic growth is not clear. (Reschovsky and Gardner)
- Reduce taxes to encourage economic growth. (Jasper, Friedman, and Kollauf)
- Sunset future tax credits to limit overspending. (Gardner)
- Adopt model tax law guidelines. (Jasper, Friedman, and Kollauf)
- Apply laws consistently without regard to entity type. (Jasper, Friedman, and Kollauf)
- Reinstate tax reciprocity with Minnesota. (Jasper, Friedman, and Kollauf)
- Adopt federal depreciation provisions. (Jasper, Friedman, and Kollauf)
- Eliminate the Wisconsin alternative minimum tax. (Jasper, Friedman, and Kollauf)
- Exempt municipal interest on all Wisconsin bonds. (Jasper, Friedman, and Kollauf)
- Reduce interest rates on underpayments. (Jasper, Friedman, and Kollauf)
- Review current administrative rules to revise or eliminate unreasonably burdensome rules. (Kollauf)
- Conform to federal law, eliminate 30% capital gain exclusion, eliminate marriage penalty in rate tables, eliminate tax credits, and adopt a single, reduced tax rate for all taxpayers. (Friedman)

Committee List

Steering Committee for Symposia Series on State Income Tax	
<p>Chair Robin Vos, Representative 960 Rock Ridge Rd. Burlington, WI 53105</p>	<p>Vice-Chair Dale Kooyenga, Representative 15365 St. Therese Blvd. Brookfield, WI 53005</p>
<p>Glenn Grothman, Senator 151 University Drive 312 N West Bend, WI 53095</p>	<p>Kathleen Vinehout, Senator W1490 Cesler Valley Rd. Alma, WI 54610</p>
<p>Jon Richards, Representative 1823 North Oakland Ave. Milwaukee, WI 53202</p>	<p>Bob Ziegelbauer, Representative 1213 South 8th St. Manitowoc, WI 54220</p>
<p>Chris Taylor, Representative 2910 Oakridge Ave. Madison, WI 53704</p>	
<p>Lena Taylor, Senator 1518 West Capitol Dr. Milwaukee, 53206</p>	

COMMITTEE ASSIGNMENT: The steering committee is directed to: conduct information symposia and develop recommendations regarding Wisconsin’s income tax code. The committee shall: review Wisconsin’s current income tax code, the income tax codes of other states, and previously proposed methods for state tax code reform; consider the social and economic effects of tax code reforms as applied to individual and corporate taxpayers as well as the fiscal effects on state revenues; and develop recommendations, in the form of a committee report, for income tax reform that would improve economic growth for residents and businesses in the State of Wisconsin.

8 MEMBERS: 5 Representatives; and 3 Senators.

LEGISLATIVE COUNCIL STAFF: Scott Grosz, Senior Staff Attorney; Dan Schmidt, Senior Analyst; and Tracey Young, Support Staff.

Committee Materials List

[Copies of documents are available at www.legis.state.wi.us/lc]

October 18, 2012 Meeting

- 5 [Guiding](#) Principles
- [Presentation](#) by Wisconsin Institute of Certified Public Accountants, *Recommendations for Wisconsin Legislative Changes*.
 - [Testimony](#), Richard Kollauf, JD, CPA, Director, Vogel Consulting Group, S.C.
 - [PowerPoint](#), Richard Kollauf, JD, CPA, Director, Vogel Consulting Group, S.C.
 - [Testimony](#), Michael Friedman, CPA, JD, Tax Director, Scribner, Cohen and Company, S.C.
 - [Testimony](#), Henry Jasper, CPA, MST.
- [Tax Policy Handbook for State Legislators](#), prepared by the Fiscal Affairs Program, National Conference of State Legislature.
- [Presentation](#) by John Koskinen, Chief Economist, Division of Research and Policy, Department of Revenue.

September 6, 2012 Meeting

- [Memo](#) summarizing states with a flat income tax rate and related exemptions.
- [Spreadsheet](#) "AggStats-96-10 shares" contains three summaries on the final sheet describing: 1) Share of Filers by Income Category, 2) Share of Wisconsin Adjusted Gross Income by Income Category; and 3) Share of Net Taxes by Income Category. The preceding sheets provide the supporting data for the summary.
- [Spreadsheet](#) "2010 Aggregate Statistics" has the most recent information relating to both the number of returns and the amounts claimed for exemptions, subtractions, and credits.
- [Wisconsin](#) Tax Incidence Study, Department of Revenue (December 16, 2004).
- [Memo](#) summarizing the Department of Revenue's collections and compliance initiatives, including audit staffing and a breakdown of delinquent taxes by type.
- [Spreadsheet](#) summarizing IRS information relating to Individual Income and Tax Data, by State and Size of Adjusted Gross Income (Tax Year 2010).
- [Map](#) of states indicating the average effective income tax rates for the bottom 20% of income level.
- [PowerPoint](#) presentation by Matt Gardner, Executive Director, Institute on Taxation and Economic Policy.
- [PowerPoint](#) presentation by Andrew Reschovsky, Professor, Public Affairs and Applied Economics, La Follette School of Public Affairs.
- [Magazine](#), *The Nation's First, The State's Largest The State Income Tax: Magnitude, Incidence, and Complexity* (April 2012), distributed by Todd Berry, President, Wisconsin Taxpayers Alliance.
- Handouts submitted by Joseph Henchman, Vice President, Tax Foundation:
 - [Wisconsin](#) Tax Facts and Comparisons
 - [Handout](#), *State-Specific Details*
 - [Table](#), *Wisconsin State-Local Tax Burden Compared to U.S. Average (1977-2009)*

July 25, 2012 Meeting

- [Memo No. 1](#) (plus attachments), *State Individual Income Tax Forms* (July 24, 2012).
- [Memo](#), *Rankings on State and Local Government Revenues and Expenditures*, from Rob Reinhardt, Program Supervisor, Legislative Fiscal Bureau (July 25, 2012).
- [Report](#), *Individual Income Tax Provisions in the States*, prepared by Rick Olin, Legislative Fiscal Bureau (July 2012).
- [Memo](#), *Information on Adjusted Gross Income and Net Individual Income Tax Liability for Six Tax Years*, prepared by Rick Olin, Legislative Fiscal Bureau (July 30, 2012).
- [Presentation](#), by John Koskinen, Chief Economist, Division of Research and Policy, Department of Revenue.

June 26, 2012 Meeting