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INTERNATIONAL PAPER

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April 15, 1999

TO THE MEMBERS OF THE JOINT COMMITTEE ON FINANCE:

On behalf of the more than 2,800 International Paper employees in Wisconsin, I respectfully urge you to eliminate from the 1999-2001 biennial budget bill the requirement that multi-state corporations report the combined income of all commonly controlled elements of a unitary business when determining the income that is taxable by Wisconsin. In addition, we hope that you retain the proposed single-factor corporate income tax apportionment system contained within that same piece of legislation.

Our company is a good example of why combined reporting is unrealistic and unfair. International Paper has been in existence since 1898, and in the course of the past century has grown through internal investment, merger and acquisition. As a result, there are several wholly owned corporate subsidiaries within the IP family. Some of these entities do business within Wisconsin, and some do not. In our opinion, the state should not have the authority to tax businesses through a combined reporting system that it could not tax utilizing the current separate entity system. The impact of combined reporting on International Paper would be an increase of well over $1 million in our state tax burden.

Conversely, we hope you retain the single-factor apportionment proposal contained within the budget bill. International Paper has nine distinct businesses within Wisconsin. These businesses compete not only with other companies, they also compete internally for investment dollars that really will determine their long-term health and economic viability. It is obvious that a single-factor corporate tax system based solely on sales would make Wisconsin a much more attractive state for businesses like International Paper to direct their corporate investments.

Thank you in advance for your consideration and support. I would be more than happy to supply any additional information you might find helpful.

Sincerely,

Dave Kluesner

Dave Kluesner

City of
BELOIT, Wisconsin

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Presentation before Joint Finance Committee

Jane Wood, City Manager
City of Beloit
April 15, 1999

Good day, Chairpersons Burke and Gard, and members of the Joint Committee on Finance. My name is Jane Wood, City Manager of Beloit. Thank you for the opportunity to offer input into the State's budget process. I am here today on a single mission – I am here to encourage this committee to reform an arcane law which prohibits Wisconsin utility holding companies from owning non-regulated assets exceeding 25% of the value of its utility assets. Repeal of the asset cap is tantamount to giving Beloit the opportunity to economically redevelop.

The City of Beloit has a unique relationship with the State – a relationship that has created a bleak financial picture for City residents. 55% of all General Government expenses, including salaries, are subsidized through the State's Shared Revenue Program. This is not a distinction we are proud to claim. As recently as last month, we were told by Wall Street to "wean" the City off its heavy dependence on State aid by growing the City's tax base. The task is difficult enough, on its own. But, with the asset cap in place, it makes it even harder.

The City of Beloit is not the picture of well-rounded financial health. The citizens of Beloit are some of the poorest in the State with the average worker earning an annual wage of $14,000. Beloit's housing values are also low – the average home in Beloit costs $54,000. Property taxes are among the highest in the State. The housing market is soft. The stagnant population growth is causing school budget cuts of $1,000,000 a year and layoffs for City workers. In addition, the per capita debit is one of the highest in the State and the City is now restricted in the amount of debt it can issue for economic development.

The City of Beloit needs opportunities to develop creative partnerships that enhance the Beloit quality of life. We need opportunities to meet the needs of our residents. The asset cap is threatening the ability of one of our economic partners to create and seize on those types of opportunities.

Alliant Energy, a Wisconsin-based utility holding company, has enhanced the quality of life in Beloit. Heartland Properties, Incorporated, which is an Alliant Energy company, has built over $200 million in affordable and accessible housing for Wisconsin. It has invested over $8 million in Beloit alone to finance affordable housing projects that serve various populations. For example, the company rehabilitated Brittan House in Beloit to create 45 single-room occupancy efficiency apartments for homeless men. It invested over $4 million to provide 77 apartment homes for families. And, furthermore, through a grant from the Alliant Energy Foundation, our historic stone Water Tower was restored and the area around it developed as a City park. There are more examples, but suffice it to say that these type of investments have made a significant difference in our community and they have enhanced the overall quality of life.

The asset cap is problematic because it makes future projects like these less probable. Since Heartland Properties in on the non-utility side of Alliant Energy's business, success – like the success we've had in Beloit – actually inhibits the company's ability to diversify and to invest in my community. It isn't fair, and it isn't good for Wisconsin communities.

Beloit must grow to meet its financial obligations of the future. Growth means less dependency on the State's shared revenue formula; lower taxes for the poorest of Wisconsin's citizens; and stability for the Beloit School District. Repealing the asset cap will support that growth. Repealing the asset cap will stimulate commerce, create jobs and further diversify our economy. Wisconsin should encourage growth in diverse industries, rather than penalize successful companies that have the resources and the desire to grow – particularly when they, in turn, benefit the communities in which they do business.

By Allowing Cities like Beloit and Green Bay to partner with utility companies for economic development initiatives, the State is providing us with the tools to help ourselves.

WISCONSIN PROPOSED COMBINED REPORTING LEGISLATION
GE POSITION PAPER

Issue:

Proposed 1999-2001 State budget would require corporations to file on a combined reporting/unitary basis.

GE is concerned about this proposed tax provision for the following reasons:

Summary

- Creates anti-competitive business environment. Wisconsin would be among only 15 states to require combined reporting.
- Complex method of taxation leading to increased administrative, compliance and litigation costs for both the taxpayer and the Department of Revenue.
- Revenue impact is uncertain at best with short term revenue loss to Wisconsin as taxpayers file in most beneficial way.

In summary, the adoption of combined reporting would place Wisconsin "behind the curve" on state tax policy and would be fiscally and administratively unsound. Most importantly, however, it causes a major setback in the efforts to attract and retain new jobs and investments in our state.

Discussion

- **Anti-Competitive** – The national trend is clearly away from combined reporting, not towards it. Only 15 states require combined reporting. The last state to adopt this method was Florida -- over 15 years ago. Florida later repealed this legislation, but not before a Fortune 50 company relocated 10,000 jobs out of Florida and another decided not to expand its operations in Florida. More recently, two states (Alabama and Kentucky) considered adopting combined filing but rejected it due to its anticipated negative impact on economic development.
- **Complexity** – Combined filing runs counter to the principle of simplicity. The definition of what constitutes a unitary business is a fact driven and subjective determination. Even where the critical factors (centralized management, functional integration, and economies of scale) are well defined, the application of these standards to individual taxpayer circumstances will lead to numerous controversies, many of which will ultimately be decided through litigation. This will lead to

increased compliance and administrative burdens for both taxpayers and the Department of Revenue.

- **Revenue Impact** – The main purpose of any state tax structure is to effectively and efficiently provide adequate revenues to finance the operation of state government. However, revenue determinations under combined reporting cannot be reliable and in fact, combined reporting could reduce rather than increase revenue to the State because the determination of what constitutes a unitary business is subjective. Taxpayers who benefit from combined reporting will file in that manner, however, taxpayers facing a tax increase under that method will plan accordingly by either:

  - Taking return positions most consistent with their own view of relevant facts;
  - Moving physical, financial or human capital out of Wisconsin; or
  - Rearranging corporate structures and operations, which will result in increased administrative cost to the State in the form of more complicated audits and litigation.

  In short, such a drastic and unpredictable change in Wisconsin's fundamental income tax structure would be fiscally and administratively unsound.

Competitiveness – All these considerations are relevant to Wisconsin's business climate. A 1996 study performed by Professor William A. Raabe on the effects combined reporting on Wisconsin's economy indicates that Wisconsin's corporate taxpayers currently face a high tax burden and adoption of combined reporting will only serve to enhance that. This is a critical factor in corporate decisions to relocate, expand or acquire new operation in a state.

Example - ABC Company, which is not currently doing business in Wisconsin, decides it wants to open a plant or service center ("NEWCO") in Wisconsin. During the first couple of years NEWCO generates a loss as a result of its initial investment in WI and normal business development. Under current law, NEWCO would pay no Wisconsin income tax until it was profitable. However, under the proposed unitary reporting NEWCO would pay tax in Wisconsin as a result of its non-Wisconsin affiliates income.

Conclusion

GE urges members of the Joint Finance Committee to remove the combined reporting/unitary tax provision from AB133/SB45.

Thank you for your consideration.

Dear

I am writing regarding the proposed tax on the sale of timeshare weeks and the tax on timeshare maintenance fees. As an owner of a Wisconsin timeshare product and as a Wisconsin resident, I am opposed to this tax that has been recently introduced in the biannual budget bill (Assembly Bill #133 and Senate Bill #45)

When I purchased my timeshare, I received a deeded interest in real property, condominium documents, and a condominium budget. My real estate deed, condominium documents and maintenance fees are no different that those of a whole ownership condominium. Why is the state now saying that my purchase is different? Timeshare associations function exactly like other not-for-profit condominium or homeowners' associations, which do NOT pay sales tax on their maintenance fees, annual assessments or real estate taxes. If timeshare condominium ownership begins to be taxed, is the state going to tax all homeowners' associations?

My vacation ownership insures that my family vacations yearly and spends our vacation dollars in Wisconsin. Taxing our maintenance fees may make vacations is other states a better value for our money. Timeshare ownership has made vacation property ownership affordable for my family. The state that once protected my timeshare ownership as "a separate estate in real property" as stated in the Wisconsin Statutes, Chapter 707.03(2), now looks to treat it entirely different and begin a tax on ownership in real property. I only wonder where it will all end?

Thank you for taking the time to review my concerns. I would very much like to hear back from you as to where you stand on this issue.

Yours Truly,

** All timeshare purchases are taxed as real estate and pay a real estate transfer fee. Wisconsin Statutes, Chapter 707 defines timeshares as interests in real property, 707.03 sub 2.

** This tax is simply unfair. Timesharing is a recognized form of real estate ownership in every state and under federal tax law. No other state applies a sales tax to real estate sales. This tax will discourage tourism in the state.

** A timeshare interest is no different than a condominium. All it is, is a condominium divided into a smaller fraction. Just like condominium owners share common areas in the building and the real estate outside the building, timeshare owners also share these same things. Just as a condominium owner receives a warranty deed, so does a timeshare owner. Just as a condominium owner is assessed maintenance fees by their Board of Directors to cover the costs of operating the condominium, a timeshare owner is also assessed by their Board to cover operating costs. Condominium maintenance fees are not taxed. Why are timeshares being singled out?

** The imposition of a sales tax on timeshare weeks is double taxation. This is not merely double taxation in a traditional sense where one item might be subject to different taxes. This double taxation results in classifying timeshare interest first of all as real estate, and then going back and trying to re-classify this property as personal property. This is what is unconstitutional about the imposition of sales tax on timeshare interest. Wisconsin statutes clearly define timeshare as real estate. (Chapter 707.03 sub 2) Therefore, it cannot be subject to sales tax as personal property.

** Imposition of sales tax on timesharing hurts the average person. It doesn't hurt the high income person who can afford to own a whole interest in a big condominium. It hurts the individuals who are trying to provide second home vacation experiences for their families.

** No other states have a sales tax on timeshare maintenance fees. At least forty-four other states specifically define timeshare interests as real property. The federal government has defined timeshare property as real property. For tax purposes, timeshare is recognized as the equivalent of all other vacation or second home properties under the federal tax laws. IRS Regulation 24 CFC 1.

We need to put a stop to this now! We need to stop this attempt to tax our maintenance fees!

Sincerely,

Robert J. Boll

[redacted]

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To: Members of the Joint Finance Committee

From: Dan Thompson, Executive Director Dan

Date: April 15, 1999

Re: 1999-01 Biennial Budget Bill

On behalf of the League of Wisconsin Municipalities, I'd like to comment on four items in the 1999-01 state budget bill. They are: shared revenue, property tax exemptions, transportation aid and municipal recycling grants.

Shared Revenue. The budget bill holds the shared revenue program, including the expenditure restraint and small communities improvement programs, at 1995 funding levels. This does not represent cost to continue for state support of municipal services. Without adequate funding of the shared revenue program, local officials will be forced to cut essential services or raise property taxes. We are concerned about losing the historic partnership between state and local government to provide basic municipal services.

Property Tax Exemptions. The League opposes further erosion of the property tax base. The budget bill expands the list of exempt personal property to include fax machines, copiers, cash registers and ATMs. Local officials are opposed to this exemption unless it is administered the same way that computer equipment is handled under current law. Local officials would prefer to keep the tax base and have the state refrain from enacting property tax exemptions.

Transportation Aid. The program where the Committee has the most discretion to help local governments is the transportation fund. The League of Wisconsin Municipalities has joined with other associations representing local government, labor unions, environmentalists and senior citizens to propose a long term plan to increase state support for maintaining and repairing local roads.

The coalition supports increases in state funding for local government transportation aid and assistance programs to 50% of total Department of Transportation expenditures over the next ten years.

Municipal Recycling Grants. The League's position is that the state should fully-fund local recycling activities, either through general purpose revenues or a tipping fee surcharge. If the Legislature cannot fund the municipal recycling grant program at 100%, then the Legislature should eliminate the mandate. The proposed budget reduces the municipal recycling grant program from $24 million in 1998 to $20 million in 1999 and $15 million in 2000, which is a small fraction of the mandated recycling costs.

Conclusion. Local officials depend on state legislators to provide cost to continue funding in support of existing services. This budget doesn't do that. We hope legislators will assist local officials in improving the partnership that delivers services to Wisconsin's citizens. Thank you for your consideration.

Community Bankers of Wisconsin

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Public Hearing of the
Joint Committee on Finance

SB 45/AB 133 – State Budget – Combined Reporting
Thursday, April 15, 1999

Testimony of Daryll Lund, President & CEO
Community Bankers of Wisconsin

Chairpersons Burke and Gard and members of the committee, my name is Daryll Lund, President & CEO of the Community Bankers of Wisconsin (CBW). CBW is a statewide trade association representing the interests of 220 community based financial institutions.

The average size of our bank members is $76 million in assets. These banks are typically located on Main Street in the heart of the community and are vital to the growth and prosperity of those Wisconsin communities. Community banks reinvest local deposits back into the community in the form of loans. Many of these loans help create jobs in small businesses, farming, manufacturing and housing. Wisconsin community banks have reinvested, on average, 95% of their loan portfolio in their own communities and almost 100% of their total loan portfolio here in Wisconsin.

I appear before you today to testify in opposition to the combined reporting proposal contained within the state budget.

Some of the key points I would like to make are as follows:

1. **If enacted combined reporting will negatively impact the competitiveness of Wisconsin community banks.**

Wisconsin community banks face an increasingly competitive marketplace. Community banks today compete against larger multi-state banks, brokerage firms, mutual fund companies, finance companies, credit unions and Internet banks. Some of these competitors enjoy regulatory and income tax advantages over community banks. State boundaries are also being dissolved. Enacting combined reporting in Wisconsin will enable out of state financial institutions to have a competitive advantage over Wisconsin community banks when doing business in our state.

We will be sharing with you information which supports this point.

2. **If enacted combined reporting will likely accelerate the mergers within the community banking industry.**

Wisconsin currently has approximately 360 banks compared to 644 banks in 1980. Several factors have led to this decline including increased competition, economies of scale and increased pressure to achieve earnings performance objectives. One of the major impacts of combined reporting will be a reduction in the earnings performance of many community banks. If combined reporting is enacted the overall stock value of the bank is diminished because stock is sold today as a multiple of earnings. The reduction in earnings may result in pressure from the shareholders to sell the bank.

We will be sharing with you information which supports this point.

3. **If enacted combined reporting will make Wisconsin a less attractive state to have a bank headquarters.**

I mentioned earlier in my testimony that in today's financial services marketplace state boundaries are being dissolved. Interstate banking and branching has contributed to this fact. Multi-state financial institutions consider basing their headquarters in the state that provides the most beneficial tax and regulatory environment. Community banks that are on the state border will also have to make a decision on whether Wisconsin is the best state to be headquartered. Overall community banks are more restricted in their ability to move interstate since they manage almost no out-of-state activities. Wisconsin loses jobs and tax revenues if even one bank decides to move their headquarters out of state.

For these reasons the Community Bankers of Wisconsin encourages your opposition to the combined reporting proposal. Thank you.

Wisconsin Bank Tax Laws Compared to Neighbors

Neighboring States	Do they tax interest from federal obligations?	What tax rate do they apply to banks?	For multi-state banks, how do they apportion income?
Iowa	Yes	5% (**less than half** the top rate on regular corporations, 12%)	single-factor on receipts
Illinois	**No**	7.18% combined rate (net income **excludes** US interest)	single-factor on receipts
Michigan	**No**	2.3%	single-factor on receipts
Minnesota	Yes	9.8%	70-15-15, heavily-weighted on receipts
Wisconsin	**Yes**, but current law allows many banks to offset this by moving investments to out-of-state related corporations. The proposed changes would encourage multi-state banks to source more of their operations outside Wisconsin.	**7.9% on all income including US interest**	A planned Technical Amendment to the Budget Bill would codify a single-factor apportionment for financial institutions. Multi-state banks will still be able to apportion income outside Wisconsin, but community banks would be taxed at Wisconsin's high rates on 100% of their income.

The reasons given for the corporate tax reform provisions are to **restore competitive balance with our neighboring states** and to **join the majority of states** and the emerging pattern of corporate taxation in the industrial midwest.

Wisconsin is in the minority of states that tax U.S. interest, even though they recently won a case on the right to do so. Other than Minnesota, all of our neighbors have more favorable state tax rates on banks. This change (combined reporting with no Treasury exclusion or rate reduction) would put **Wisconsin banks at a competitive disadvantage** with our neighbors. Please don't forget Wisconsin banks while you are restoring the competitive balance with our neighboring states.

Impact to Value of Business

Actual Bank Example

		Gross Receipts	Percentage		Taxable Income		Tax
In Wisconsin	$	6,856,938	84.11%	$	492,672	$	39,906
Outside Wisconsin		1,295,436	15.89%		1,264,229		-
	$	8,152,374	100.00%	$	1,756,901	$	39,906

Wisconsin tax rate		7.9%
Proposed tax	$	138,795
Current tax		39,906
Tax increase from combined reporting	$	98,889
Stock valuation PE ratio		20
Decrease in value of Bank to current shareholders	$	1,977,780

Bank Industry's Current Tax Burden Ranking With Our Neighbors
Tax Expense from 1997 FDIC Call Reports, by State

All Banks	Iowa	Wisconsin	Illinois	Michigan	Minnesota
Total Commercial Banks	453	361	784	163	520
Total Employees (full-time equivalents)	15,858	23,993	72,960	42,907	41,300
Net income for commercial banks from 1997, millions	581	840	2,685	1,645	1,926
Income Taxes	258	381	1,228	852	1,083
Net income before taxes	839	1,221	3,913	2,497	3,009
Tax burden as percent of Net income before taxes	30.75%	31.20%	31.38%	34.12%	35.99%
Tax burden if $44 million* is added, net of federal savings		33.58%			

Banks Under $100 million	Illinois	Iowa	Wisconsin	Minnesota	Michigan
Commercial Banks under $100 million	502	376	244	426	89
Employees (full-time equivalents)	8,925	5,891	4,845	7,016	2,611
Net income for commercial banks from 1997, millions	234	178	131	188	44
Income Taxes	85	70	53	86	22
Net income before taxes	319	248	184	274	66
Tax burden as percent of Net income before taxes	26.65%	28.23%	28.80%	31.39%	33.33%

How much of the $44 million would come out of banks under $100 million?
Where would this move our ranking for smaller banks?

Banks $100 million to $1 billion	Illinois	Iowa	Wisconsin	Michigan	Minnesota
Commercial Banks $100 million to $1 billion	261	72	110	65	89
Employees (full-time equivalents)	23,344	5,435	9,769	6,754	7,171
Net income for commercial banks from 1997, millions	784	184	330	169	244
Income Taxes	323	76	150	81	125
Net income before taxes	1,107	260	480	250	369
Tax burden as percent of Net income before taxes	29.18%	29.23%	31.25%	32.40%	33.88%

In this category, Wisconsin is already a couple percentage points above Illinois and Iowa.
Where would our ranking move in this category?

Banks $1 billion and over	Wisconsin	Illinois	Iowa	Michigan	Minnesota
Commercial Banks $1 billion and over	7	21	5	9	5
Employees (full-time equivalents)	9,379	40,691	4,532	33,542	27,113
Net income for commercial banks from 1997, millions	379	1,667	219	1,432	1,494
Income Taxes	178	821	111	749	872
Net income before taxes	557	2,488	330	2,181	2,366
Tax burden as percent of Net income before taxes	31.96%	33.00%	33.64%	34.34%	36.86%

* Per Department of Revenue estimates

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The reasons given for the corporate tax reform provisions are to **restore competitive balance with our neighboring states** and to **join the majority of states** and the emerging pattern of corporate taxation in the industrial midwest.

Wisconsin is in the minority of states that tax U.S. interest, even though they recently won a case on the right to do so. Other than Minnesota, all of our neighbors have more favorable state tax rates on banks. This change (combined reporting with no Treasury exclusion or rate reduction) would put **Wisconsin banks at a competitive disadvantage** with our neighbors. Please don't forget Wisconsin banks while you are restoring the competitive balance with our neighboring states.

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ECONOMIC IMPACT OF SINGLE FACTOR SALES APPORTIONMENT: JOB CREATION AND TAX REVENUES

by

Austan Goolsbee and Edward Maydew
University of Chicago

John Healy and Michael Schadewald
University of Wisconsin-Milwaukee

February 1999

We thank the Wisconsin Manufacturers & Commerce for funding this research.

ECONOMIC IMPACT OF SINGLE FACTOR SALES APPORTIONMENT: JOB CREATION AND TAX REVENUES

EXECUTIVE SUMMARY

This study estimates the impact that switching to a single factor sales apportionment formula would have on job creation and tax revenue for the State of Wisconsin. The estimates we present are based on the actual experiences of other states that have modified their apportionment formulae from 1978 to 1995. The analysis controls for other factors that can affect employment, such as state corporate income tax rates, state trends, state personal income growth rates, national unemployment rates, and the actions of other states regarding their apportionment formulae. We find that increasing the weight on the sales factor has significant positive effects on in-state employment. Based on the analysis, we estimate that switching to single factor sales apportionment will have a long-run impact of increasing the number of manufacturing jobs in Wisconsin by about 2.9 percent, or 18,000 new jobs. We further estimate that the number of non-manufacturing jobs would grow by 2.4 percent, or 49,000 new jobs. Together these jobs would have significant positive impact on the individual income taxes collected by the State of Wisconsin, creating an estimated $51 million in additional annual tax revenue. In sum, we find clear evidence that the adoption of a single factor sales apportionment formula should increase employment, generating additional personal income and individual income tax revenues for the State of Wisconsin. Coupled with neighboring states' aggressive modification of their own apportionment formulae, these results underscore the need for the State of Wisconsin to act promptly to remain competitive and avoid revenue and job losses to other states.

ECONOMIC IMPACT OF SINGLE FACTOR SALES APPORTIONMENT: JOB CREATION AND TAX REVENUES

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WHAT IS APPORTIONMENT?

Wisconsin corporate income tax collections totaled $627 million in fiscal year 1998, or roughly 7 percent of the state's total tax collections.[1] Wisconsin taxes the entire taxable income of corporations that conduct business solely within the State of Wisconsin. For example, if a small retailer has stores and makes sales only in Wisconsin, all of that retailer's income is subject to Wisconsin taxation. On the other hand, if a corporation does business and is subject to taxation in two or more states, the Supreme Court has ruled that the taxpayer has the right to have its income fairly apportioned among the taxing states.[2] In such cases, neither Wisconsin nor any other state is entitled to tax the corporation's entire income. Instead, each state can tax only that portion of the corporation's income attributable to assets and activities located within its borders. Therefore, if a retailer has stores located in both Wisconsin and Minnesota, Wisconsin can not tax 100 percent of the retailer's income, but rather must settle for taxing that amount of income that can be fairly apportioned to Wisconsin.

States use apportionment formulae to compute the percentage of a multistate corporation's total income that is taxable in a particular state. Apportionment formulae vary from state-to-state, but are usually based on the relative amounts of property, payroll and sales that a corporation has in a state. Historically, the most common approach has been to equally weight these three "factors," such that the state apportionment percentage equals the average of the property, payroll and sales factors, as follows:

$$\text{Apportionment \%} = \left(\frac{\text{property in} - \text{state}}{\text{total property}} + \frac{\text{payroll in} - \text{state}}{\text{total payroll}} + \frac{\text{sales in} - \text{state}}{\text{total sales}} \right) \Big/ 3$$

To illustrate, consider a corporation that does business in two states, X and Y. Assume the corporation's total taxable income is $10 million, and that it has 40 percent of its property, 30 percent of its payroll, and 20 percent of its sales in State X. If State X uses an equally-weighted three-factor formula, the corporation's State X apportionment

1 Wisconsin Department of Administration, *1998 Annual Fiscal Report*.

2 *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 1977.

percentage is 30 percent ([40% + 30% + 20%]/3), in which case State X is entitled to tax the corporation on $3 million (30% × $10 million) of income.

Wisconsin currently uses an apportionment formula that includes all three factors, but with a double-weighting on sales.[3] This means that the sales factor is weighted 50 percent (rather than 33 percent as in an equally-weighted formula), while the property and payroll factors are weighted 25 percent each. The purpose of this report is to evaluate whether Wisconsin should consider amending its corporate income tax laws to adopt a single factor sales apportionment formula.

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3 Wis. Sec. 71.25(6).

HOW THREE-FACTOR APPORTIONMENT PENALIZES IN-STATE INVESTMENT

Criteria for a "Good" Tax

An essential first step in evaluating the pros and cons of any proposed change in tax policy is to clearly identify the government's objectives with respect to taxation. Although different groups may suggest different criteria, there is general agreement regarding the following core criteria for what makes a good tax.

- **Raising revenues**: The purpose of taxation is to raise revenues to provide public services, the level of which is determined by elected officials. A good tax should provide adequate revenues to cover budgeted outlays.
- **Economic growth**: A good tax does not impede economic growth by distorting the incentives of taxpayers to work hard, save and invest. In a free-market economy, consumers and businesses are assumed to be the best judges of what goods and services should be produced, and how resources should be allocated. Taxes can interfere with this natural efficiency since taxing an activity will tend to reduce the level of that activity. Therefore, a good tax neither favors nor disfavors particular types of economic activity, but instead allows free market forces to shape the decisions of consumers and businesses.
- **Simplicity**: A good tax is easy for taxpayers to understand and compute. A bad tax is complex and administratively costly, causing taxpayers to expend undue amounts of time and money to compute and pay their taxes, and making it burdensome for state authorities to administer the tax.
- **Fairness**: A good tax distributes the total tax burden among taxpayers in an equitable manner. Unfortunately, the concept of tax equity is difficult to define or measure, and ultimately involves ethical issues and value judgements. Nevertheless, tax reforms always invoke discussions of equity and fairness, and the accompanying debate is often an emotional one for lawmakers and taxpayers alike.

Disincentives Created by Property and Payroll Factors

Wisconsin's economic future depends on the degree to which businesses are encouraged to locate, expand or retain their operations in Wisconsin. Businesses consider a number of factors when deciding where to locate their operations, including the quality and cost of labor, proximity to markets, transportation costs, the cost of utilities, and the quality of local schools and other public services. To a great extent, this is a cost-minimization decision, and therefore differential tax burdens can play a significant role in determining where a business chooses to locate or expand. Economists have done extensive research on this issue, and have found that corporate income taxes and other tax factors can have a significant effect on a region's economic development.[4] The impact of differential tax burdens can be particularly strong when a business is choosing between alternative sites within the same regional area (e.g., the economic corridor that lies along Interstate 94 between Chicago and Milwaukee), since non-tax factors such as labor costs may be quite similar within that region.

A three-factor apportionment formula attempts to measure the contribution of a corporation's capital (property), labor (payroll) and market (sales) in generating its business profits, and apportions that contribution to the state in which the underlying property, payroll or sales are located. Unfortunately, by apportioning income to a state in direct proportion to the amount of property and payroll located in the state, the three-factor formula imposes a tax penalty on businesses that choose to add jobs or expand their facilities within that state. In effect, including property and payroll in an apportionment formula transforms a state corporate income tax into a direct tax on the amount of property and payroll located within the state.[5]

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4 For reviews of this research, see Phillips and Goss, "The Effect of State and Local Taxes on Economic Development: A Meta-Analysis," *Southern Economic Journal*, October 1995; Bartik, "The Effects of State and Local Taxes on Economic Development: A Review of Recent Research," *Economic Development Quarterly*, February 1992; and Wasylenko, "Taxation and Economic Development: The State of the Economic Literature," *New England Economic Review*, March-April 1997.

5 Gordon and Wilson, "An Examination of Multijurisdictional Corporate Income Taxation Under Formula Apportionment," *Econometrica*, November 1986.