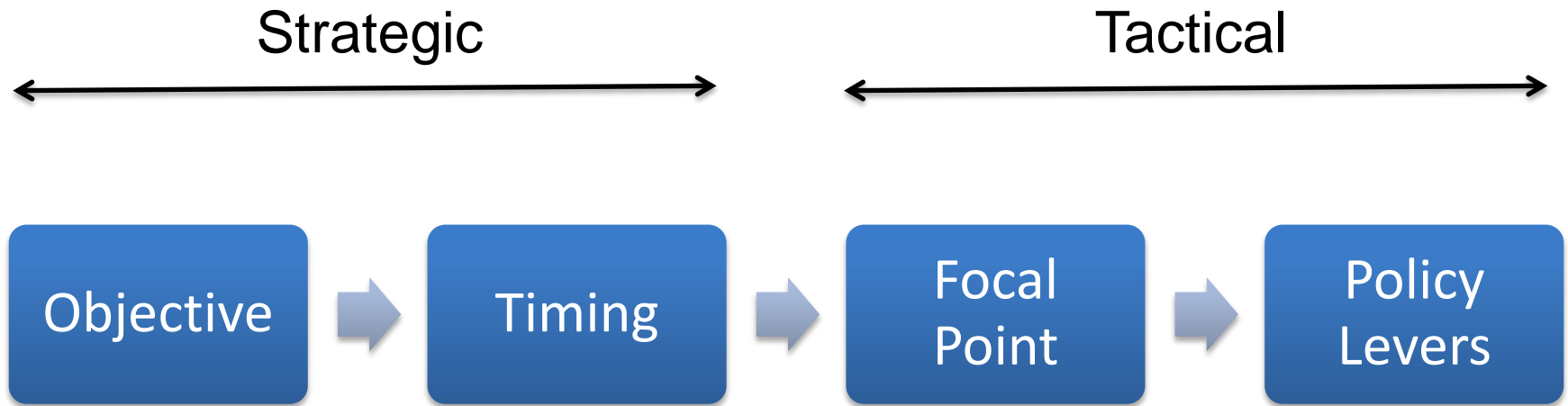


# Strategic Considerations for Individual Income Tax Reform

October 18, 2012

# Mapping Income Tax Reform



# Strategic Objectives

Improve Economic Competitiveness

Reduce Burden

Reduce Ranking

Tax Simplification

# Revenue Neutral Objective Tax Simplification—Conform to IRC

- Wisconsin's selectively conforms to the IRC standards.
- This allows the state's decision-makers to choose its own tax policy rather than let the federal government set Wisconsin's decisions.
- There are 48 deviations from Wisconsin's Income Tax Law and the Internal Revenue Code

# Income Tax Preference Items: Adjustments & Modifications to Federal Income (Largest Preferences Highlighted)

Adjustments to Federal Gross Income	FY10 Fiscal Effect
Health Insurance of Self-Employed Persons	22,600,000
Self-Employment Tax	18,700,000
Pension, Profit-Sharing, Annuity and Bond Purchase	14,700,000
Individual Retirement Accounts (IRAs)	14,400,000
Alimony	14,400,000
Student Loan Interest	11,500,000
Losses from the Sale or Exchange of Business Property	10,600,000
Capital Losses	9,710,000
Educator Expenses	1,110,000
Penalty on Early Withdrawal of Savings	167,000

Modifications to Federal Adjusted Gross Income	FY10 Fiscal Effect
Social Security Benefits: Additional State Deduction	235,000,000
Capital Gains Deduction	68,800,000
Public Pensions	51,500,000
Higher Education Tuition Expenses	34,100,000
Unemployment Compensation	24,300,000
Interest on U.S. Obligations	16,000,000
Prepaid Tuition and College Savings Plans	10,700,000
Long-Term Care Insurance Expenses	8,550,000
Active Duty Military Pay for Reserves or National Guard	6,080,000
Low Income Retirement Income Exclusion	1,790,000
Gains on Sales of Business Assets to Related Persons	910,000
Disability Income	739,000
Adoption Expenses	273,000
Health Insurance Premiums of the Self-Employed and	26,000

# Income Tax Preference Items: State Tax Deductions and Credits (Largest Preferences Highlighted)

Deductions and Exemptions from Wisconsin Adjusted Gross Income	FY10 Fiscal Effect
Sliding Scale Standard Deduction	727,000,000
Personal Exemption and Additional Elderly Exemption	187,000,000

Credits	FY10 Fiscal Effect
School Property Tax Credit	387,000,000
Itemized Deductions Credit	316,000,000
Married Couple Credit	264,000,000
Earned Income Credit	128,000,000
Homestead Credit	128,000,000
Farmland Preservation Credit	14,200,000
Farmland Tax Relief Credit	13,900,000
Veterans' and Surviving Spouses' Property Tax Credit	9,250,000
Dairy and Livestock Farm Investment Credit	6,350,000
Angel Investment Credit	3,620,000
Development Zone Credits	3,218,000
Early Stage Seed Investment Credit	1,830,000
Historic Preservation Credits	1,580,000
Armed Forces Member Credit	1,340,000
Technology Zone Credit	886,000
Dairy Manufacturing Facility Investment Credits	508,000
Manufacturing Investment Credit	393,000
Film Production Services Credit	286,000
Claim of Right Credit	232,000
Working Families Credit	189,000
Manufacturing Sales Tax Credit	184,000
Economic Development Credit	37,000
Meat Processing Facility Investment Credit	30,000
Ethanol and Biodiesel Fuel Pump Credit	23,000

# Simplification

## Consensus Recommendation

1. Reduce or Eliminate Preferences
2. Reduce Rates

# Central Problem with Eliminating Preferences to Reduce Rates

- Preferences have been established for a reason
- In a revenue neutral approach, it is simply not possible to make someone better off without making someone else worse off.



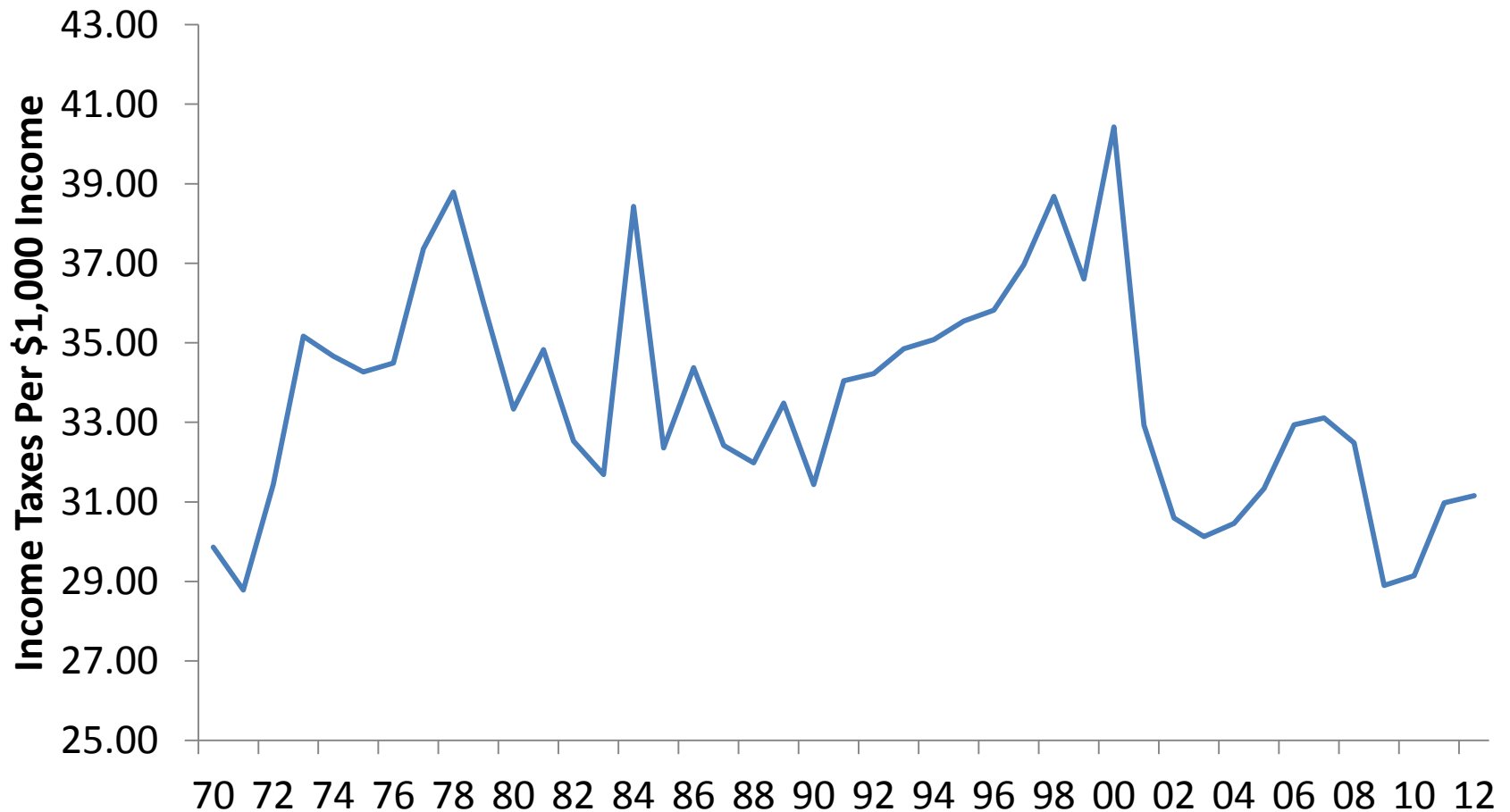
# Easier Said Than Done

## 1999-2001 Biennium's Lesson on Income Tax Reform

- Original proposal to cut income taxes 10% included elimination of the Property Tax Rent Credit, Dependent Credit, Senior Credit and Working Families Credit.
  - Extra revenue from eliminating preferences reduced rates further
- The legislature retained those credits
- A gubernatorial veto by the Governor removed the SPTRC to generate savings for a sales tax rebate.
- Subsequent legislation restored the SPTRC.
- End Result: No credits were eliminated.

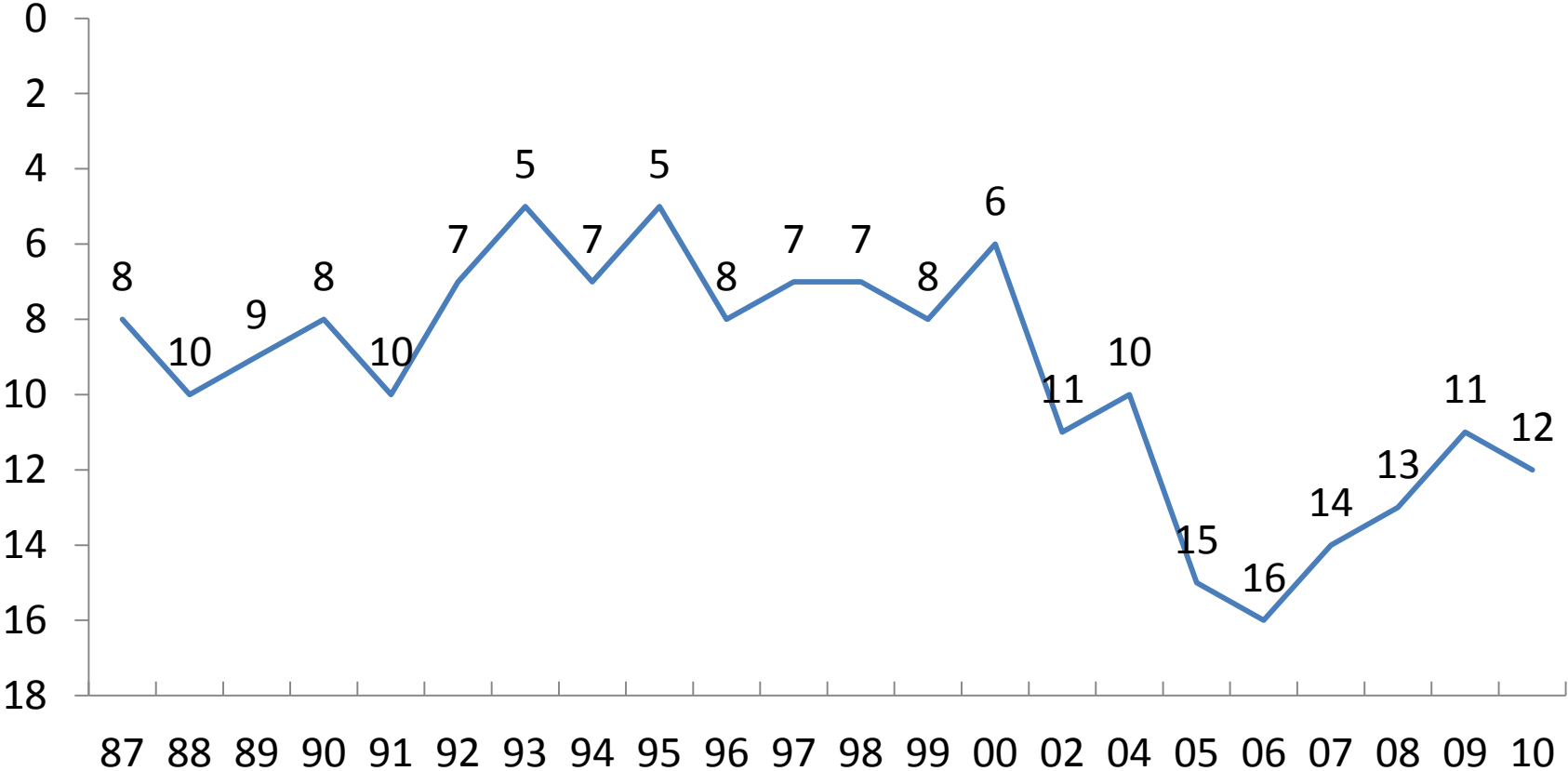
# Objective: Reduce the Income Tax Burden

2000 & 2001 Tax Reforms Permanently Reduced  
Wisconsin's Income Tax Burden



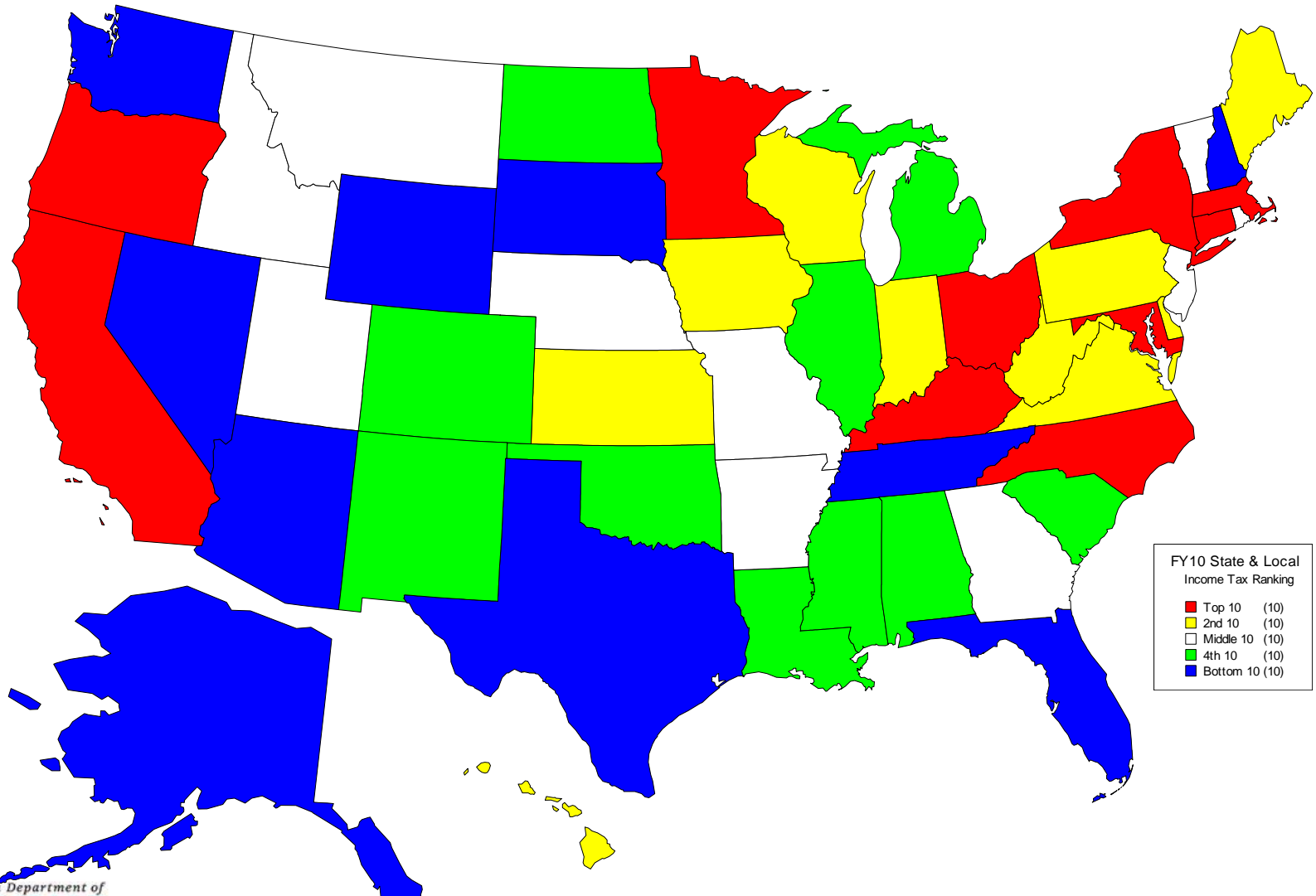
# Objective: Reducing Tax Ranking

Wisconsin's Income Tax Ranking Among the 50 State & DC



# Reduce the State's Income Tax Ranking

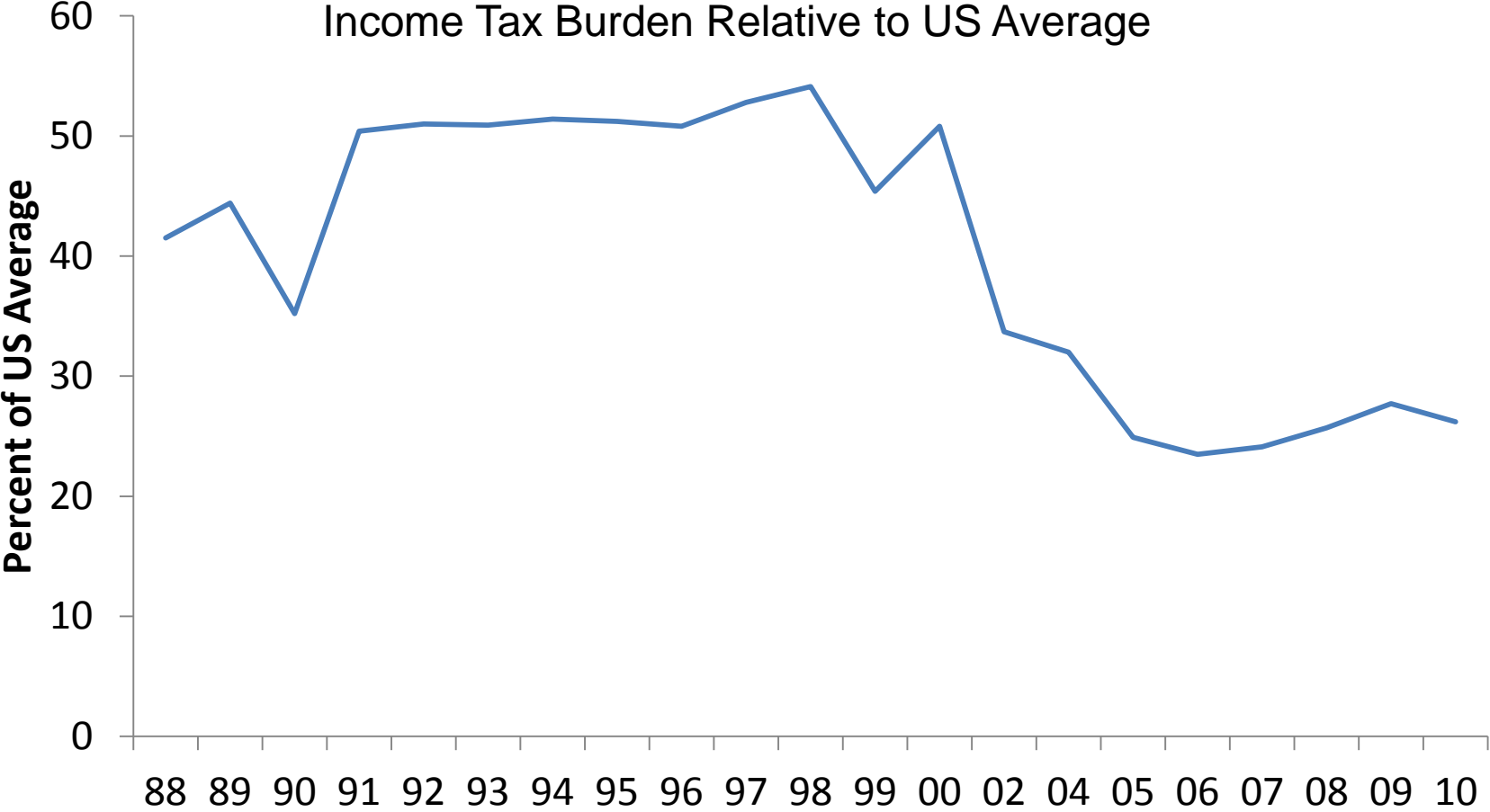
Wisconsin Ranks 12<sup>th</sup> in State and Local Income Tax Burden



FY10 State & Local  
Income Tax Ranking

Red	Top 10	(10)
Yellow	2nd 10	(10)
White	Middle 10	(10)
Green	4th 10	(10)
Blue	Bottom 10	(10)

# Income Tax Burden Remains over 26% Above US Average



# Funding & Timing Strategies

1. Immediate

2. Phased

# Execute Immediately

- Revenue Neutral Objectives can be implemented immediately
- Reduction Objectives require a significant cash allocation to execute

# Funding and Timing

- Fixing the objective sets the funding target.
- Existing growth revenue constrained by other pressures.
- Reductions could be phased-in over a five or ten year period.



# Order of Magnitude: Setting the Funding Target

- Reducing Collections 10%
  - \$715 million
- Reducing the Income Tax Ranking to 20<sup>th</sup>
  - \$966 million
- Reducing relative burden to US Average
  - \$1,860 million

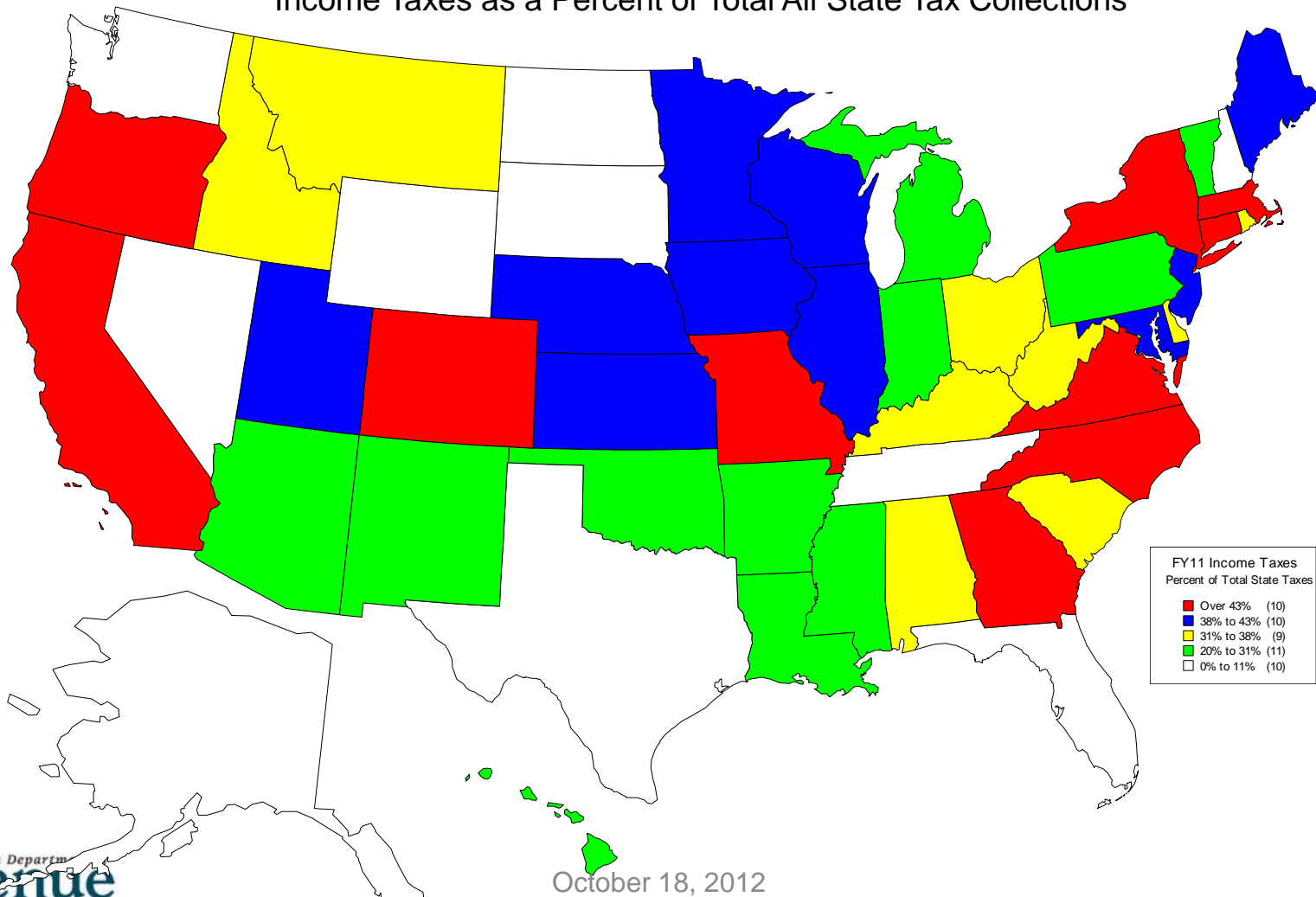
# Income Tax Burden Will Drop Because of Already Adopted Tax Cuts

Tax Law Changes	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
<b>Individual Income</b>	<b>(129,664)</b>	<b>(171,540)</b>	<b>(252,346)</b>	<b>(289,915)</b>	<b>(317,770)</b>	<b>(321,080)</b>
2011 Act 213 Lifting of Angel Investment credit cap	-	-	(2,800)	(6,300)	(6,680)	(7,080)
2011 SB 369 Credit for hiring unemployed veterans	(200)	(900)	(1,400)	(1,700)	(2,000)	(2,000)
2011 SB 203 Federalizing non-dependent adult children health care expenses	(2,700)	(1,800)	(1,800)	(1,800)	(1,800)	(1,800)
<b>2011 Act 32 (BB11-13) Qualified Production Activities Income Credit</b>	<b>-</b>	<b>(4,900)</b>	<b>(19,600)</b>	<b>(37,700)</b>	<b>(56,800)</b>	<b>(72,000)</b>
2011 Act 32 (BB11-13) Deferral of CapGains reinvested in WI Bus.	(16,100)	(20,200)	(26,500)	(24,300)	(25,500)	-
2011 Act 32 (BB11-13) CapGains Exclusion for WI Business. PIT reduced by \$6M in the first year of the phase in (FY17) and by <b>\$79M annually when fully phased in.</b>	-	-	-	-	-	(6,500)
2011 Act 1 (Special Session) H.S.A.	(20,700)	(27,300)	(27,300)	(27,300)	(27,300)	(27,300)
2011 Act 5 (Special Session) Small Business Credit	(36,500)	(39,100)	(39,100)	(39,100)	(39,100)	(39,100)
2007 Act 20 - Child/depend care (Delayed-09)	(5,600)	(10,100)	(13,500)	(15,900)	(15,900)	(15,900)
<b>2007 Act 20 - Health Insurance Premium Deduction -Delay-09</b>	<b>(13,360)</b>	<b>(32,370)</b>	<b>(86,550)</b>	<b>(92,500)</b>	<b>(98,660)</b>	<b>(104,640)</b>
2005 Act 25 Health Insurance (Delayed-09)	(10,004)	(10,370)	(10,796)	(11,315)	(12,030)	(12,760)
2009 Act 28 Cap Gain Exemp. (QNBV) for WI Business Inv.	(24,500)	(24,500)	(14,000)	(14,000)	(14,000)	(14,000)
2009 Act 161 IRA/Retirement Income			(9,000)	(18,000)	(18,000)	(18,000)
<b>General Sales and Use</b>	<b>(9,800)</b>	<b>(15,300)</b>	<b>(14,300)</b>	<b>(14,300)</b>	<b>(14,300)</b>	<b>(14,300)</b>
2007 Act 20 Exemp. Alt energy (Delayed-09) and Menasha	(3,300)	(2,300)	(1,300)	(1,300)	(1,300)	(1,300)
Exemption for Biotechnology and Manufacturing Research (ef. Jan12)	(6,500)	(13,000)	(13,000)	(13,000)	(13,000)	(13,000)
<b>Corporate Income/Franchise</b>	<b>(19,600)</b>	<b>(60,900)</b>	<b>(81,200)</b>	<b>(105,200)</b>	<b>(128,700)</b>	<b>(147,000)</b>
2011 Act 32 (BB11-13) Allow sharing of pre-2009 NOL	(9,200)	(37,200)	(39,100)	(39,100)	(39,100)	(39,100)
<b>2011 Act 32 (BB11-13) Qualified Production Activities Income Credit</b>	<b>-</b>	<b>(5,600)</b>	<b>(22,500)</b>	<b>(43,400)</b>	<b>(65,400)</b>	<b>(82,800)</b>
2011 Act 4 (Special Session) Economic Development Credit	-	-	-	(1,700)	(1,700)	(1,700)
2011 Act 5 (Special Session) Small Business Credit	(1,800)	(1,800)	(1,800)	(1,800)	(1,800)	(1,800)
2011 Act 15 - Dairy and Livestock Credit	-	(1,200)	(2,700)	(4,100)	(5,600)	(6,500)
2007 Act 20 - Electronic Medical Records (Delayed-09)	(4,500)	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)
2007 Act 20 - Community Rehab. and Biodiesel Prod. and Pump Credits (Delayed-09)	(4,100)	(5,100)	(5,100)	(5,100)	(5,100)	(5,100)
<b>Total GPR Effect</b>	<b>(159,064)</b>	<b>(247,740)</b>	<b>(347,846)</b>	<b>(409,415)</b>	<b>(460,770)</b>	<b>(482,380)</b>
<b>Marginal Change From FY12 Base</b>		(88,676)	(188,782)	(250,351)	(301,706)	(323,316)

# State Reliance On Income Tax

## Wisconsin 12<sup>th</sup> in the Nation

Income Taxes as a Percent of Total All State Tax Collections



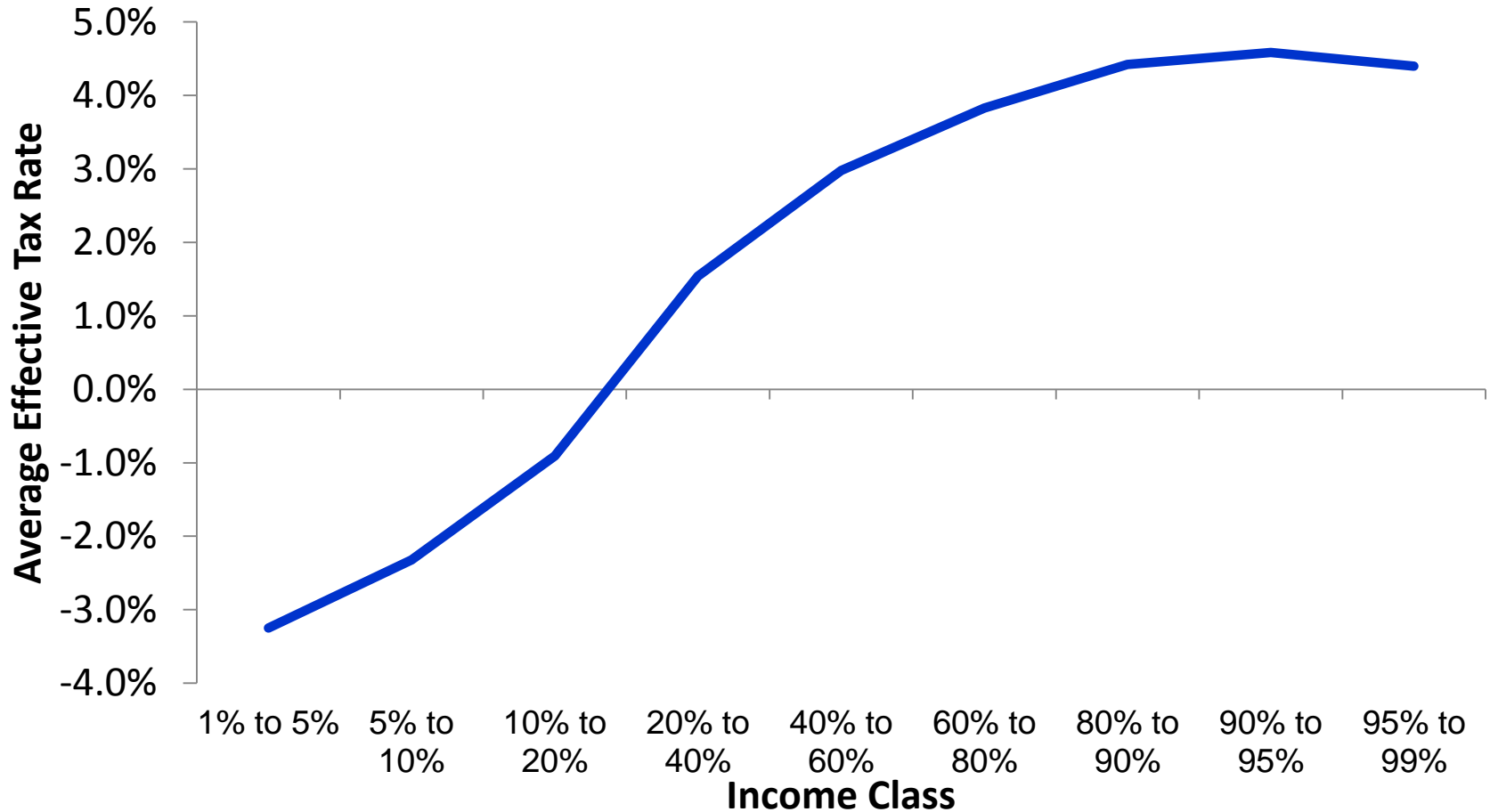
October 18, 2012

# Focal Point

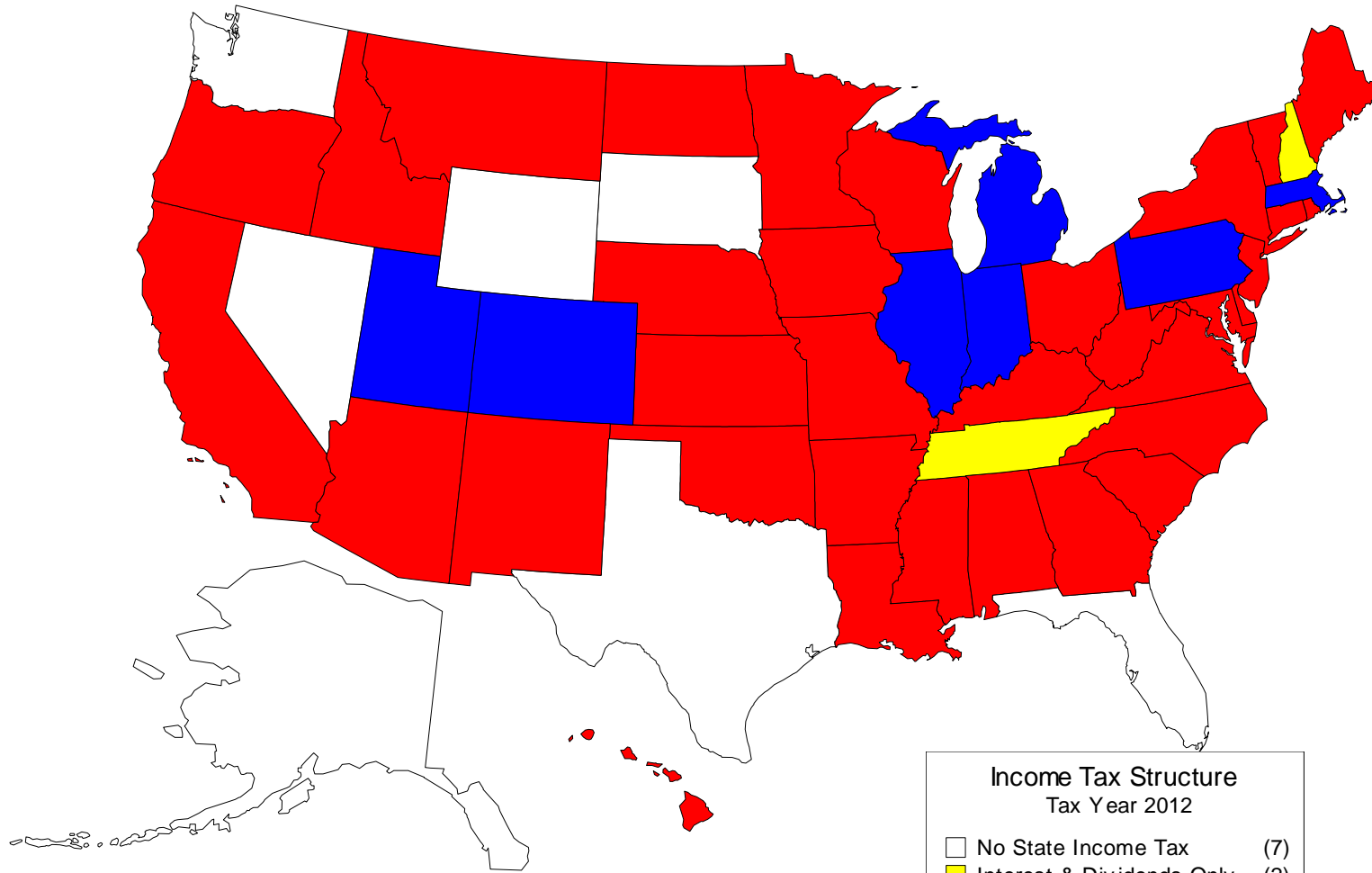
- Setting the Shape of The Curve
- Middle Class Tax Relief

# The Shape of The Curve

Wisconsin Income Tax Steeply Progressive Through Most of the Income Distribution

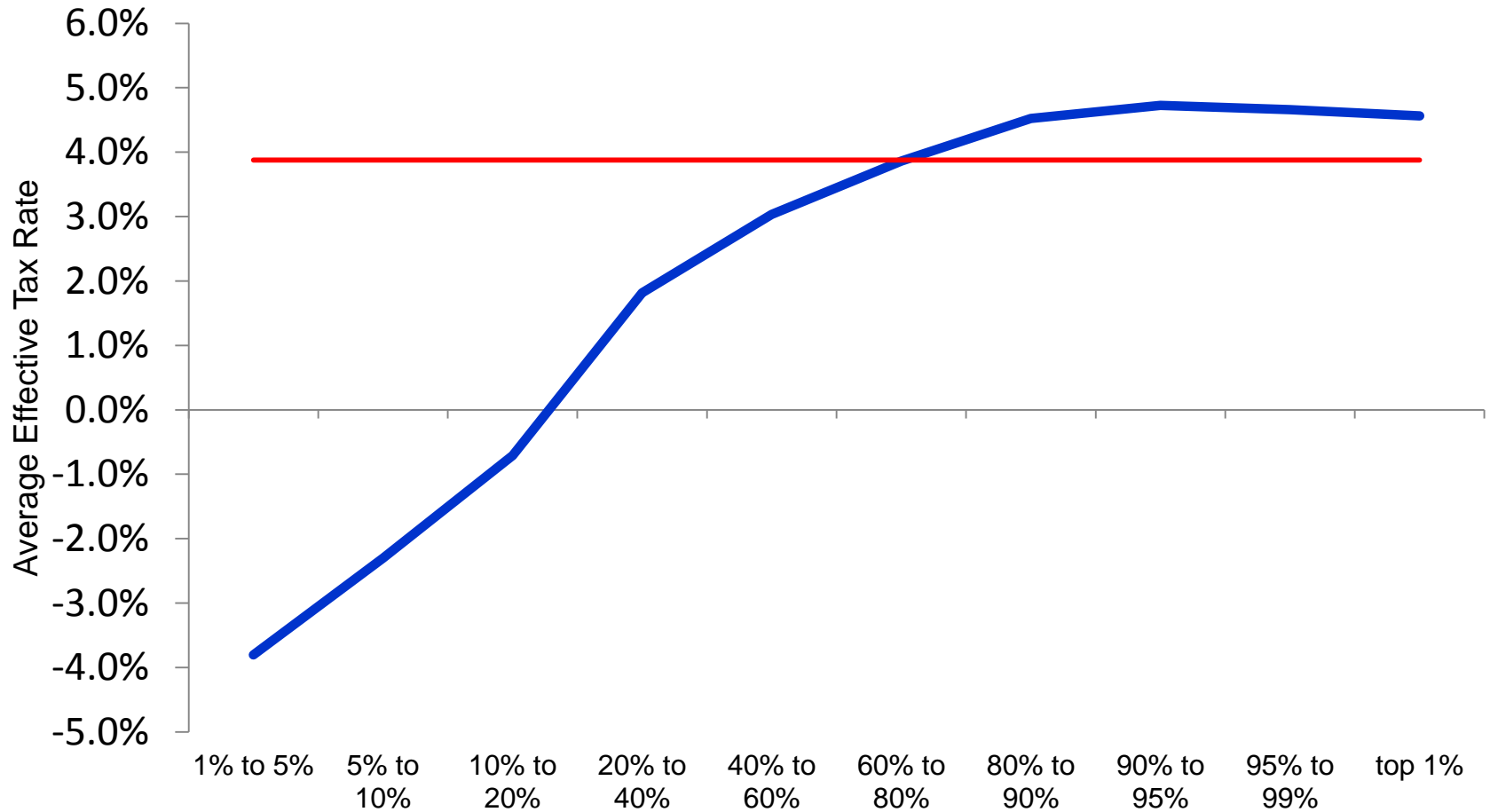


# State Income Tax Structures



# Eliminating Preferences and Reducing Rates

## Revenue Neutral Without Tax Preferences

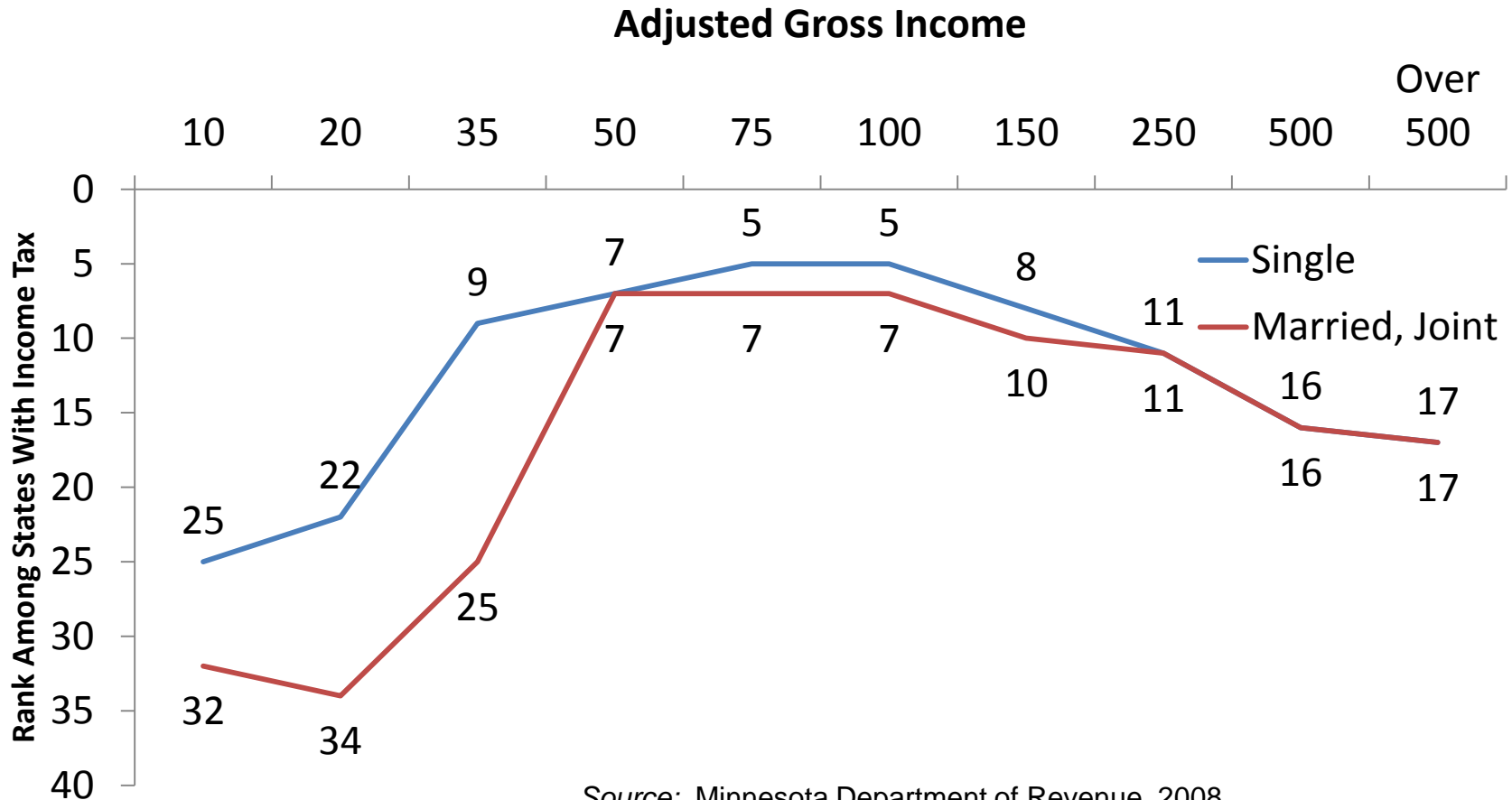


# Policy Levers

1. Change Rates
2. Change Exemptions
3. Expand Credits
4. Modify Exclusions



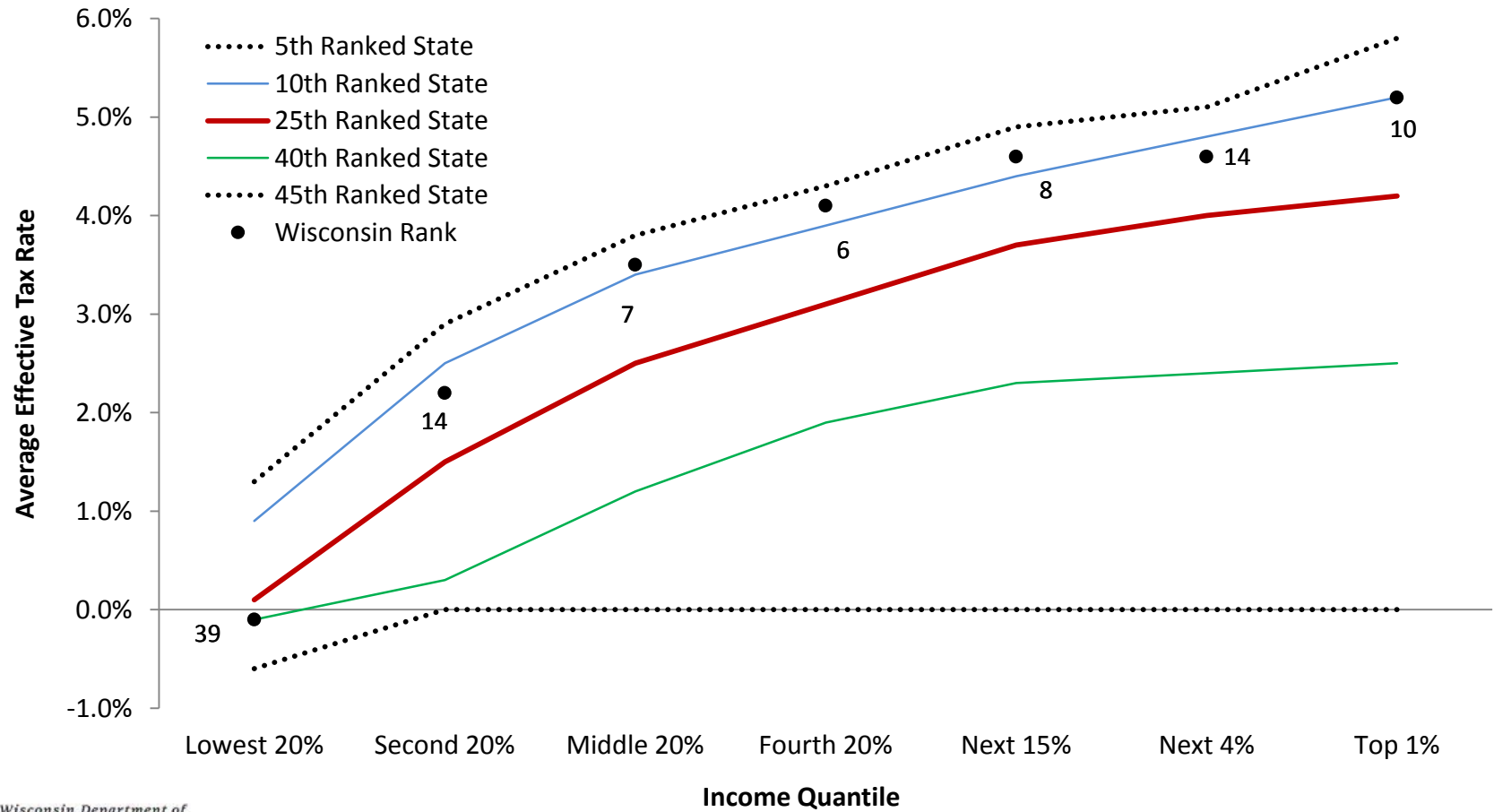
# Wisconsin Income Tax Rank by Income Class, 2008



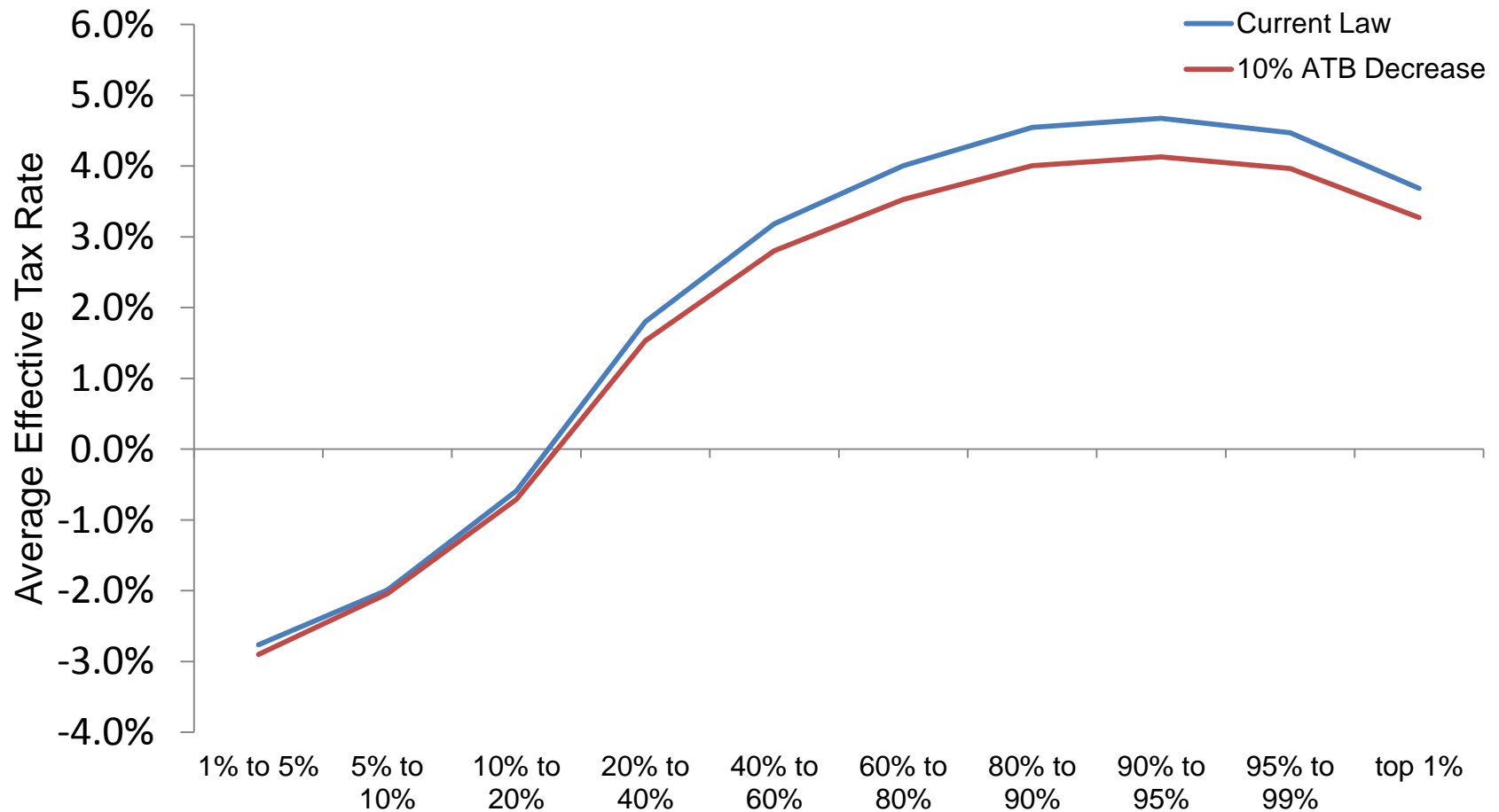
Source: Minnesota Department of Revenue, 2008

# Wisconsin Income Tax Ranking Highest in the Middle Income Ranges

Wisconsin Income Tax Rank by Income Quantile Compared to Other States

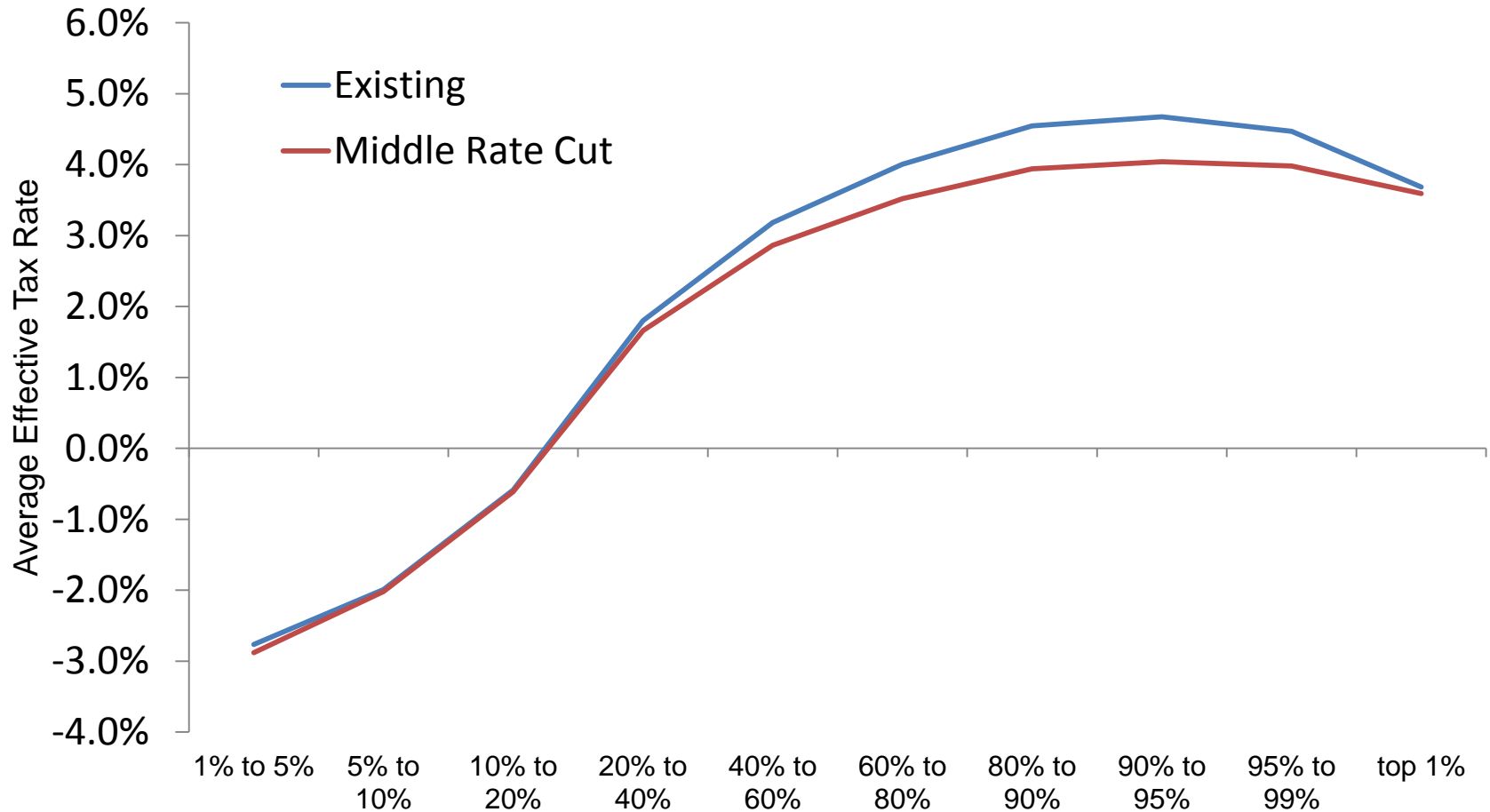


# Policy Lever: 10% Across The Board Rate Reduction



# Policy Lever

## Reduce Middle Bracket Tax Rates

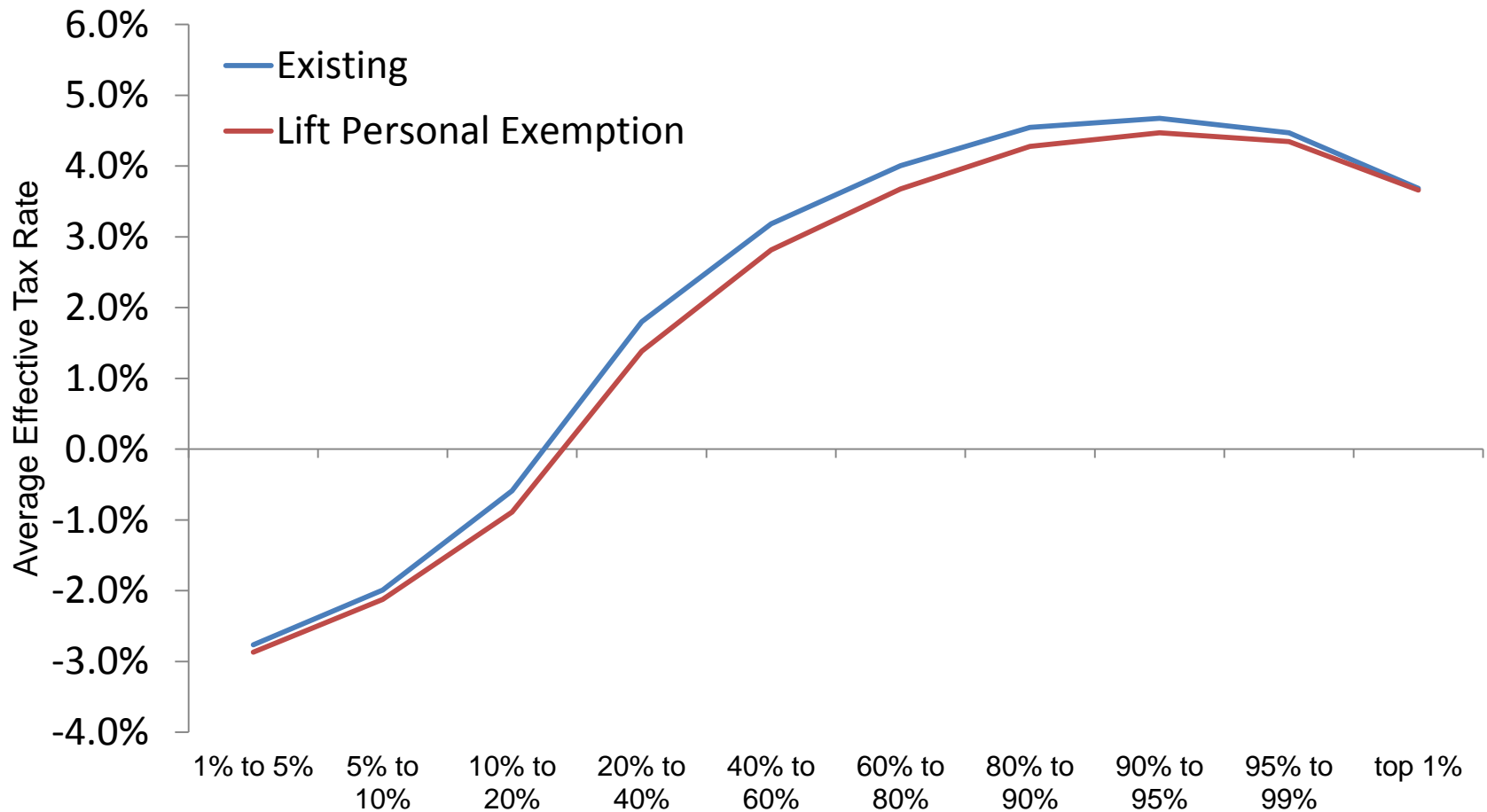


Note: This reduces the current 6.15% and 6.50% rates to 5.65%

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# Policy Lever

## Lift Personal Exemption



# Mapping Income Tax Reform

