Legislative Fiscal Bureau
One East Main, Suite 301 • Madison, WI 53703 • (608) 266-3847 • Fax: (608) 267-6873

March 4, 2002 Joint Committee on Finance Paper #1152

Alternative General Fund Revenue Sources (General Fund Taxes)

This paper presents information and fiscal estimates relating to a number of options to provide additional general fund revenue in the 2001-03 biennium. For each provision, a description of current state law is provided, along with the fiscal effect and any points to note in interpreting the data. Each fiscal estimate shows the impact of the proposal as a change to current law. If multiple provisions are adopted, the fiscal estimates may need to be adjusted to account for interaction effects.

The alternatives presented in this paper should not be viewed as comprehensive. There are many other options that could be considered by the Legislature in its deliberations on Special Session Assembly Bill 1.

Capital Gains Exclusion

Under Wisconsin law, a 60% capital gains exclusion is provided for long-term capital gains from the sale of assets held at least one year. Short-term capital gains are taxed as ordinary income. In addition to the 60% exclusion on long-term capital gains, gains realized on the sale of a business to a family member and the sale of qualifying small business stock are completely excluded from taxation. The amount of net capital losses that may be used to offset ordinary income is limited to $500 annually, with the remainder carried over to offset income in future years.

Capital gains or losses result from the sale of property designated as capital assets, including: (a) investment property such as stock, bonds or real estate; and (b) property held for personal use such as a home, household furnishings or jewelry. The sale or exchange of business or farm assets may also be treated as capital gains or losses.

If the value received for an asset exceeds its basis, then a gain occurs. Similarly, if the basis of the asset is greater than the amount received from the sale, a loss is reported. Gain or loss from the sale of an asset that is not a capital asset is taxed as ordinary income or loss. Long- and short-term losses can be used to offset long- and short-term gains, with the remaining amount defined as a net capital gain or loss.

Under federal law, capital gains on assets held for more than 12 months are taxed at a maximum marginal rate of 20% (10% for taxpayers in the 15% bracket). The amount of net capital losses that may be used to offset ordinary income is limited to $3,000 annually, with the remainder carried forward to offset income in future years.

Capital gains realizations vary significantly from year to year. The estimates provided below are based on the 1999 Wisconsin tax sample and assumptions about economic conditions over the remainder of the biennium. However, depending on market conditions and individual behavior, the actual effects of the proposals could be higher or lower than the estimates provided.

Alternatives

1. Effective for tax year 2002, eliminate the 60% state exclusion for long-term capital gains. It is estimated that this alternative would increase general fund tax collections by $212.4 million in 2002-03.

2. Effective for tax year 2002, change the 60% state exclusion for long-term capital gains to a 30% exclusion for long-term capital gains. It is estimated that this alternative would increase general fund tax collections by $105.1 million in 2002-03.

Individual Income Tax Rates

Under current law, there are four income tax brackets, which are indexed annually to account for changes in inflation. As outlined below, the marginal tax rates range from 4.6% to 6.75%.

Rates and Brackets --Tax Year 2002

Taxable Income Brackets			Marginal
Single	Married-Joint	Married-Separate	Tax Rate
Less than $8,280	Less than $11,040	Less than $5,520	4.60%
8,280 to 16,560	11,040 to 22,080	5,520 to 11,040	6.15
16,560 to 124,200	22,080 to 165,600	11,040 to 82,800	6.50
124,200 and Over	165,600 and Over	82,800 and Over	6.75

The state's individual income tax generated $5.96 billion in 1999-00 and $5.16 billion in 2000-01. Under the budget reform bill, collections are estimated to be $5.21 billion in 2001-02 and $5.31 billion in 2002-03. [The decrease in revenue from 1999-00 to 2000-01 is a result of modifications to the individual income tax enacted during the 1999 Legislative session.]

Alternatives

1. Beginning in tax year 2002, increase each of the marginal tax rates by 2.5% to rates of 4.72%; 6.30%; 6.66%; and 6.92%. The estimated fiscal effect would be an increase in general fund tax revenues in 2002-03 of $198.5 million. This estimate assumes that the withholding tables would be changed some time during the first half of the 2002-03 fiscal year to reflect the new rates. Of this amount, an estimated $141.8 million would represent the ongoing, annualized effect of increasing the tax rates and an estimated $56.7 million would be the one-time effect of changing the withholding tables.

2. Beginning in tax year 2002, increase each of the marginal tax rates by 5% to rates of 4.83%; 6.46%; 6.83%; and 7.09%. The estimated fiscal effect would be an increase in general fund tax revenues in 2002-03 of $397.6 million. This estimate assumes that the withholding tables would be changed some time during the first half of the 2002-03 fiscal year to reflect the new rates. Of this amount, an estimated $284.0 million would represent the ongoing, annualized effect of increasing the tax rates and an estimated $113.6 million would be the one-time effect of changing the withholding tables.

3. Beginning in tax year 2002, increase each of the marginal tax rates by 10% to rates of 5.06%; 6.77%; 7.15%; and 7.43%. The estimated fiscal effect would be an increase in general fund tax revenues in 2002-03 of $796.7 million. This estimate assumes that the withholding tables would be changed some time during the first half of the 2002-03 fiscal year to reflect the new rates. Of this amount, an estimated $569.1 million would represent the ongoing, annualized effect of increasing the tax rates and an estimated $227.6 million would be the one-time effect of changing the withholding tables.

Individual Income Surtax

A surtax may be imposed on the individual income tax to increase general fund revenues on a temporary basis. The surtax could be computed as a percentage of either gross tax liability or net tax liability.

Alternatives

(Fiscal Effect in Millions)

1. Provide a temporary, individual income surtax on gross tax liability for tax year 2002 at one of the rates identified below. [A surtax based on gross tax liability is similar to the 10% surtax that was used in 1983.]

Option	2002-03
5%	$284.0
10%	569.1

2. Provide a temporary, individual income tax surtax on net tax liability for tax year 2002 at a rate of:

Option	2002-03
5%	$242.3
10%	484.6

Indexing of Individual Income Tax Brackets and Standard Deduction

Under current law, the income tax brackets and the standard deduction are indexed annually for inflation. The tax brackets for 2002 are shown in the table under "Individual Income Tax Rates," above. The standard deduction formulas for 2002 are outlined below.

Standard Deduction --Tax Year 2002

Filing Status	Wisconsin AGI	Standard Deduction
Single	Less than $11,020	$7,650
	$11,020 to $74,770	$7,650 – 12%(WAGI-$11,020)
	Greater than $74,770	$0
Married, Joint	Less than $15,470	$13,770
	$15,470 to $85,093	$13,770– 19.778%(WAGI-$15,470)
	Greater than $85,093	$0
Married, Separate	Less than $7,350	$6,540
	$7,350 to $40,417	$6,540 – 19.778%(WAGI-$7,350)
	Greater than $40,417	$0
Head-of-Household	Less than $11,020	$9,880
	$11,020 to $32,228	$9,880 – 22.515%(WAGI-$11,020)
	Greater than $32,228	Single Standard Deduction

Alternatives

1. Suspend indexing of the income tax brackets for tax year 2002. Instead, maintain the tax brackets as in 2001, which are outlined below.

Alternative Tax Brackets -- Tax Year 2002

Taxable Income Brackets			Marginal
Single	Married-Joint	Married-Separate	Tax Rate
Less than $8,060	Less than $10,750	Less than $5,380	4.60%
8,060 to 16,130	10,750 to 21,500	5,380 to 10,750	6.15
16,130 to 116,330	21,500 to 155,100	10,750 to 77,550	6.50
116,330 and Over	155,100 and Over	77,550 and Over	6.75

The estimated fiscal effect would be to increase general fund tax revenues in 2002-03 by $11.0 million. There would be no effect in subsequent fiscal years, as the suspension of indexing would apply to tax year 2002 only.

2. Suspend indexing of the standard deduction for tax year 2002. Instead, maintain the standard deduction formulas as in 2001, which are outlined below.

Alternative Standard Deduction -- Tax Year 2002

Filing Status	Wisconsin AGI	Standard Deduction
Single	Less than $10,730	$7,440
	$10,730 to $72,730	$7,440 – 12%(WAGI-$10,730)
	Greater than $72,730	$0
Married, Joint	Less than $15,070	$13,410
	$15,070 to $82,872	$13,410– 19.778%(WAGI-$15,070)
	Greater than $82,872	$0
Married, Separate	Less than $7,160	$6,370
	$7,160 to $39,367	$6,370 – 19.778%(WAGI-$7,160)
	Greater than $39,367	$0
Head-of-Household	Less than $10,730	$9,620
	$10,730 to $31,460	$9,620 – 22.515%(WAGI-$10,730)
	Greater than $31,460	Single Standard Deduction

The estimated fiscal effect would be to increase general fund tax revenues in 2002-03 by $26.2 million. There would be no effect in subsequent years, as the suspension of indexing would apply to tax year 2002 only.

3. Suspend indexing of the tax brackets and the standard deduction for tax year 2002. Instead, maintain the brackets and the standard deduction formulas as in 2001, as outlined in the two preceding alternatives. Under this option, it is estimated that general fund tax revenues would increase by $37.3 million in 2002-03. This estimate is slightly higher than adding the effects of the two individual alternatives as a result of interaction effects.

Corporate Tax Rate

Under Wisconsin law, a flat 7.9% corporate income tax rate is applied to all income subject to the state corporate income tax.

Alternatives
(Fiscal Effect in Millions)

1. Effective for tax year 2002, increase the corporate income tax rate from 7.9% to:

Option	2002-03
8.0%	$10.2
8.4%	50.8
8.9%	101.6

The estimates include one-time revenues from reconciling the timing of declaration and final tax payments. The one-time amounts are $3.2 million for the 8.0% rate, $15.8 million for the 8.4% rate and $31.5 million for the 8.9% rate.

Corporate Surtax

A surtax may be imposed on the corporate income and franchise tax to increase general fund revenues on a temporary basis. The surtax would be computed as a percentage of net tax liability, prior to the subtraction of tax credits.

Alternatives
(Fiscal Effect in Millions)

1. For tax year 2002, impose a temporary surtax on corporate income and franchise tax net tax liabilities at a rate of:

Option	2002-03
5%	$29.2
10%	58.3

Combined Reporting

In general, the Wisconsin corporate income and franchise tax is computed using federal provisions to determine income and deductions and then apportioning the net income of a multistate corporation, applying the tax rate and allowing for any credits. Under current Wisconsin law, each separate corporation, including a member of a group of affiliated corporations, is taxed as a separate entity. Each individual corporation reports its own income, its own deductions and its own net tax due.

Alternative

1. Require corporations that are subject to the state corporate income and franchise tax and that are members of an affiliated group engaged in a unitary business to compute state corporate income and franchise tax liability using the combined reporting method of determining income. It is estimated that adopting combine reporting would increase state corporate income and franchise tax revenues by $70.0 million annually.

Sales Tax

Wisconsin currently imposes a 5% general sales tax on gross receipts from the sale and rental of all personal property not specifically exempted and selected services specifically listed in the statutes.

Alternatives
(Fiscal Effect in Millions)

1. Effective July 1, 2002, increase the current 5.0% sales tax rate to:

Option	2002-03
5.5%	$383.0
6.0%	766.0

2. Modify the goods and services currently exempt from the tax to include additional taxable items as identified in the attachment to this memorandum. The estimates in the attachment, which were prepared by the Department of Revenue, assume an effective date of July 1, 2002. Additional lead time may be necessary to identify and contact retailers if a significant base expansion were adopted.

Certain expenditures for large, high-cost items are volatile and may be sensitive to changes in interest rates and other economic conditions. Further, to a certain extent, purchases by exempt buyers and noncompliance by certain sellers may lower the projected sales tax estimate. To account for noncompliance, an adjustment has been incorporated to reflect a reduced fiscal estimate for some items. Finally, the attachment excludes certain exempt goods which are believed to be minimal or are impossible to estimate.

Excise Taxes

Under current law, excise taxes are imposed on cigarettes, tobacco products, liquor, wine and beer. The current law rates, along with a range of alternatives to increase each tax, follow:

Alternatives
(Fiscal Effect in Millions)

	2002-03
Cigarettes -- 77 cents per pack	
Increase 5 cents/pack	$20.3
Increase 10 cents	40.4
Increase 50 cents	191.1
Increase $1.00	355.5
Tobacco Products -- 25% of Manufacturer's List Price	
Increase to 30% of manufacturer's price	3.1
Increase to 35% of manufacturer's price	6.2
Beer Tax -- $2.00 per 31 gallon barrel	
Increase rate $.50 per barrel	2.4
Increase rate $1.00 per barrel	4.7
Increase rate $2.00 per barrel	9.4
Liquor and Wine Tax -- Liquor, 85.86 cents per liter/ wine under 14%, 6.605 cents per liter/wine with 14% to 21%, 11.89 cents per liter/ hard cider, 1.71 cents per liter	
10% rate increase	3.6
20 % rate increase	7.2

The effective date for the excise tax increases is assumed to be July 1, 2002. Whenever there is an increase in an excise tax, additional revenues are realized from a floor tax on inventories. The floor tax is incorporated in the cigarette tax estimates. Data is not available for other excise taxes; however, the fiscal effect would be significantly less than for cigarettes. The estimates for the cigarette tax have also been adjusted to account for refunds of the tax on cigarettes sold by Indian tribes.

Prepared by: Drew B. Larson, Faith Russell and Ron Shanovich

ATTACHMENT

Revenue Gain from Eliminating Sales and Use Tax Exemptions and Imposing the Tax on Exempt Services (In Millions)

	2002-03*
Exemptions for Property Sold Primarily to Households	
Food	$580.00
Meals Furnished by Institutions of Higher Education	8.40
Water Sold Through Mains	16.20
Fuel and Electricity for Residential Use	81.00
Long-Term Rental Payments for Residential Real Estate	195.00
Manufactured Homes and Mobile Homes Used as Primary Housing	2.70
Motor Fuels	182.00
Newspapers, Periodicals and Shoppers Guides	12.20
Caskets and Burial Vaults	8.40
Coin-Operated Laundry and Dry Cleaning Services	2.50
Cloth Diapers and Diaper Services	0.04
Exemptions Related to Health Care	
Prescription Drugs and Medicines	83.00
Equipment Used in the Treatment and Testing of Diabetes	1.00
Medical Equipment	10.80
Accommodations Provided by Hospitals, Nursing Homes, Nonprofit Associations and Religious Organizations	134.00
Exemptions Related to Farming	
Farm Machinery	28.00
Electricity Used in Farming	5.50
Fuel Used in Farming	3.70
Veterinary Services and Medicines for Farm Livestock	4.50
Semen for Livestock Breeding	1.90
Milkhouse Supplies	3.90
Exemptions Related to Nonfarm Businesses	
Machinery and Equipment Used in Manufacturing	246.00
Waste Treatment Facilities	29.00
Logging Equipment	0.50
Wood Residue Used as Fuel in a Business Activity	0.10
Long-Term Rental Payments for Real Estate Used for Business Purposes	305.00
Trucks, Tractors, Buses and Other Vehicles Sold to Common or Contract Carriers	27.00
Commercial Vessels and Barges	0.50
Rolling Stock Used in Railroad Operations	8.70
Motion Picture and TV Film	2.50

*Assumes an effective date of July 1, 2002.

	2002-03*
Exemptions for Government Agencies and Nonprofit Organizations	
Sales to State and Local Governments and Schools	$195.00
Religious, Charitable, Scientific and Educational Organizations	49.00
Charges for Emergency Telephone Systems	0.55
Hot Lunches and Other Personal Property Sold by Elementary and Secondary Schools	7.20
Certain Items Sold by the Department of Agriculture, Trade and Consumer Protection	0.02
Fees for Admission and Camping at State Parks	0.60
Admissions to Certain Historical Museums	0.05
Definitional and Miscellaneous Exemptions	
Labor Input into Construction	310.00
Trade-Ins	78.00
Personal, Recreational and Related Services	
Beauty and Barber Services	17.90
Funeral Services	7.60
Bank Account Service Charges	24.00
Dues and Fees Paid to Business Associations and Fraternal Organizations	12.40
Live Bands and Orchestras	0.20
Health and Reducing Clubs	7.00
Admissions to Educational Events and Places	5.60
Veterinary Services for Pets	9.50
Dance Studios	0.10
Auto and Travel Clubs	1.70
Professional Services	
Services of Physicians, Dentists and Other Health Professionals	220.00
Legal Services	82.00
Architectural, Engineering and Surveying Services	54.00
Accounting Services	47.00
Business Services	
Advertising	83.00
Computer Services	110.00
Management Consulting and Public Relations	43.00
Personnel Services	65.00
Addressing and Mailing	8.60
Credit Rating and Collection Services	6.30
Protective Services	12.30
Research, Development and Testing Services	13.60
Services Related to Real Property	
Commissions to Real Estate Brokers	36.00
Repair of Real Property	25.50
Interior Design	2.80
Janitorial Services	20.00
Disinfecting and Exterminating Services	2.40
Sewerage Services	22.80

*Assumes an effective date of July 1, 2002.
Source: Department of Revenue