Legislative Fiscal Bureau

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Additional Income Tax Bracket
(General Fund Taxes -- Income and Franchise Taxes)

[LFB 2009-11 Budget Summary: Page 253, #1]

CURRENT LAW

The individual income tax rates and brackets for tax years 2008, 2009, and 2010 are displayed below. The tax rate structure is cumulative so that marginal tax rates apply only to income that falls within the appropriate bracket. Prior to tax year 2000, the tax structure consisted of three brackets, but the 1999-01 biennial budget modified the tax rate and bracket structure by creating a fourth income bracket and reducing the tax rates. The rates were reduced in two steps, first for tax year 2000 and then again for tax years 2001 and thereafter. Since tax year 1999, the tax brackets have been indexed annually for changes in inflation.

	Tax Year 2008		
	Single	Married-Joint	Married-Separate
Rates and Estimated Brackets -- Current Law			
4.60%	Less than $9,700	Less than $12,930	Less than $6,470
6.15	9,700 to 19,400	12,930 to 25,860	6,470 to 12,930
6.50	19,400 to 145,460	25,860 to 193,950	12,930 to 96,980
6.75	145,460 and Over	193,950 and Over	96,980 and Over

	Tax Year 2009		
	Single	Married-Joint	Married-Separate
Rates and Estimated Brackets -- Current Law			
4.60%	Less than $10,220	Less than $13,620	Less than $6,810
6.15	10,220 to 20,440	13,620 to 27,250	6,810 to 13,620
6.50	20,440 to 153,280	27,250 to 204,370	13,620 to 102,190
6.75	153,280 and Over	204,370 and Over	102,190 and Over

	Tax Year 2010		
	Single	Married-Joint	Married-Separate
Rates and Estimated Brackets -- Current Law			
4.60%	Less than $9,820	Less than $13,090	Less than $6,550
6.15	9,820 to 19,640	13,090 to 26,190	6,550 to 13,090
6.50	19,640 to 147,320	26,190 to 196,420	13,090 to 98,210
6.75	147,320 and Over	196,420 and Over	98,210 and Over

GOVERNOR

Create a fifth income tax bracket and extend a rate of 7.75% to income exceeding the following thresholds in tax year 2009: (a) $225,000 for fiduciaries, single individuals, and heads of households: (b) $300,000 for married persons filing joint returns; and (c) $150,000 for married persons filing separate returns. The rate and bracket structure under the Governor's proposal is shown below.

	Tax Year 2009		
	Single	Married-Joint	Married-Separate
Governor's Proposed Rates and Estimated Brackets			
4.60%	Less than $10,220	Less than $13,620	Less than $6,810
6.15	10,220 to 20,440	13,620 to 27,250	6,810 to 13,620
6.50	20,440 to 153,280	27,250 to 204,370	13,620 to 102,190
6.75	153,280 to 225,000	204,370 to 300,000	102,190 to 150,000
7.75	225,000 and Over	300,000 and Over	150,000 and Over

	Tax Year 2010		
	Single	Married-Joint	Married-Separate
Governor's Proposed Rates and Estimated Brackets			
4.60%	Less than $9,820	Less than $13,090	Less than $6,550
6.15	9,820 to 19,640	13,090 to 26,190	6,550 to 13,090
6.50	19,640 to 147,320	26,190 to 196,420	13,090 to 98,210
6.75	147,320 to 216,250	196,420 to 288,330	98,210 to 144,160
7.75	216,250 and Over	288,330 and Over	144,160 and Over

Beginning in tax year 2010, the thresholds dividing the fourth and fifth brackets would be indexed using the same procedures currently authorized for indexing the existing tax brackets. The bill would first extend the new bracket in tax year 2009, unless the bill's effective date is after August 31, in which case the new bracket would first apply to taxable years beginning on or after the following January 1.

When the bill was introduced, the administration estimated that these modifications would increase individual income tax collections by $175,563,000 in 2009-10 and $136,194,000 in 2010-11. This assumes that the new bracket would first apply in tax year 2009, but that there would be no change in withholding or estimated tax payments until July 1, 2009. Consequently, the revenue increase for 2009-10 exceeds the increase for 2010-11 due to one-time effects from the withholding table change. Interest charges on tax underpayments would be waived if the deficiency is due to the creation of the new bracket.

DISCUSSION POINTS

1. Since the Governor introduced AB 75, the condition of the nation's economy has deteriorated, and the state is expected to collect less individual income taxes in the 2009-11 biennium than previously estimated. Consequently, the additional revenues likely to be realized by the Governor's recommendation to create an additional income tax bracket are also lower and are estimated at $163.4 million in 2009-10 and $124.0 million in 2010-11. Initially, increases of $175.6 million in 2009-10 and $136.2 million in 2010-11 were estimated for AB 75, so the reestimates reduce the estimated revenue increase by $24.4 million in the biennium.

2. The highest tax rate imposed under the state's individual income tax was 11.40%, which was imposed between 1972 and 1978. The top tax rate was reduced to 10.0% between 1979 and 1985, to 7.9% for 1986, and to 6.93% beginning with tax year 1987. It remained at that level through tax year 1997, when it was reduced to 6.77% for tax years 1998 and 1999. The top tax rate has been set at 6.75% since tax year 2000.

3. Changes in the top tax rate have generally been accompanied by changes in the rates for the other income tax brackets. The tax rate reductions and other income tax provisions that occurred after 1985 have affected Wisconsin's individual income tax ranking relative to other states in two widely recognized measures compiled by the U.S. Department of Commerce. When measured as taxes per $1,000 of personal income or as taxes per capita, Wisconsin had the eighth highest 1984-85 individual income tax burden among the states. Under each measure, Wisconsin's tax ranking improved slightly after 1984-85, but then increased through 1999-00. At that time, Wisconsin ranked sixth highest under the personal income measure and ninth highest under the per capita measure. However, Wisconsin's tax ranking has decreased under each measure since tax year 2000 when a variety of income tax changes took effect that included tax rate reductions, tax indexing, expansion of the sliding scale standard deduction, and an increase in the property tax/rent credit. In 2005-06, Wisconsin ranked 16th highest under the personal income measure and 15th highest under the per capita measure.

TABLE 1

Wisconsin Individual Income Tax Ranking Under Two Measures, Selected Years

	Taxes Per $1,000 of Personal Income			Taxes Per Capita		
	Amount	Rank	Difference from U.S. Average	Amount	Rank	Difference from U.S. Average
1984-85	$32.17	8	49.8%	$423.17	8	43.1%
1989-90	31.27	9	35.3	535.19	11	26.4
1994-95	35.78	5	51.3	758.55	9	46.4
1999-00	41.13	6	51.5	1,107.53	9	47.7
2005-06	32.60	16	24.5	1,059.91	15	17.9

Sources: U.S. Census Bureau and Bureau of Economic Analysis.

4. For tax year 2009, the Department of Revenue (DOR) projects that 28,000 of the state's 2,794,000 filers, or 1.1%, would fall in the Governor's proposed tax bracket. Their Wisconsin adjusted gross income (AGI) represents 13.9% of total estimated Wisconsin AGI. Relative to their proportion of taxpayers, these individuals would pay a larger percentage of net tax (18.8%). Also, they are more likely to incur a minimum tax liability (6% of these filers, as opposed to 1% of all filers). Table 2 reports the estimated distribution of taxpayers that would experience a tax increase and indicates that 98.1% of the increase would be borne by taxpayers with adjusted gross incomes above $300,000. Taxpayers with lower incomes that would experience increases consist of non-resident and part-year residents who apportion part of their income to Wisconsin for taxation, as well as single filers with incomes of $225,000 to $300,000 and married-separate filers with incomes between $150,000 and $300,000.

TABLE 2

Distribution of Taxpayers with a Tax Increase
Under AB 75 Proposal to Create an Additional Income Tax Bracket

	Taxpayers With a Tax Increase						% of All
Wisconsin Adjusted Gross Income	Count	Percent of Count	Amount of Tax Increase	Percent of Amount	Average Increase	Count of All Returns	Returns in AGI Class
Under $5,000	1,474	5.3%	$15,334	0.01%	$10	345,665	0.4%
5,000 to 10,000	868	3.1	29,165	0.03	34	263,941	0.3
10,000 to 15,000	570	2.0	34,942	0.03	61	212,780	0.3
15,000 to 20,000	415	1.5	37,615	0.03	91	191,541	0.2
20,000 to 25,000	286	1.0	31,689	0.03	111	179,699	0.2
25,000 to 30,000	250	0.9	35,114	0.03	140	166,691	0.1
30,000 to 40,000	397	1.4	66,912	0.06	169	283,322	0.1
40,000 to 50,000	338	1.2	74,495	0.07	220	224,322	0.2
50,000 to 60,000	240	0.9	69,080	0.06	288	186,831	0.1
60,000 to 70,000	203	0.7	67,519	0.06	333	159,464	0.1
70,000 to 80,000	178	0.6	63,353	0.06	356	130,073	0.1
80,000 to 90,000	172	0.6	67,283	0.06	391	102,086	0.2
90,000 to 100,000	156	0.6	64,196	0.06	412	77,801	0.2
100,000 to 150,000	595	2.1	318,251	0.29	535	173,287	0.3
150,000 to 200,000	434	1.5	310,341	0.28	715	44,189	1.0
200,000 to 250,000	521	1.9	320,009	0.29	614	17,412	3.0
250,000 to 300,000	805	2.9	498,897	0.45	620	9,306	8.7
300,000 and over	20,128	71.8	108,459,840	98.10	5,389	25,709	78.3
TOTALS	28,030	100.0%	$110,564,035	100.00%	$3,944	2,794,119	1.0%

SOURCE: Wisconsin Department of Revenue, 2007 Individual Income Tax Statistics.

5. Additional insight regarding these taxpayers can be obtained from federal tax return data for Wisconsin residents. The data pertains to tax year 2007 and, unlike the preceding data, has not been adjusted to reflect tax year 2009. It also differs from the preceding data by not including returns from non-residents. Because the data is organized by each percentile of tax filer, those filers comprising the top 1% of all Wisconsin filers are used to represent the taxpayers that would be subject to the proposed tax bracket. Table 3 reports federal AGI by source of income for the 1% of filers with the highest income and for all Wisconsin taxpayers. For tax year 2009, this distribution is likely to differ due to changes in asset markets.

TABLE 3

Distribution of 2007 Federal AGI by Source of Income
Top 1% vs. All Wisconsin Taxpayers

Income Source	Top 1%	All Filers
Wages, Salaries, Tips, etc.	43%	72%
Partnerships and S Corporations	21	4
Net Capital Gains	20	5
Dividends	5	2
Taxable Interest	4	3
Sole Proprietorships	2	2
Other	5	12
Total	100%	100%

6. Relative to all Wisconsin taxpayers, taxpayers with the top 1% of federal AGI are slightly more likely to report wage income (87% versus 84%), but wage income is a less significant component of their total federal AGI (43% versus 72%). Table 4 indicates that these taxpayers are more likely to report other forms of income relative to the universe of taxpayers.

TABLE 4

Percentage of Taxpayers Reporting Certain Types of Income, 2007

Type of Income	Top 1% of Filers	All Filers
Taxable Interest	98%	55%
Wages	87	84
Net Capital Gains	84	22
Dividends	85	27
Income from Partnerships and S Corporations	46	3
Business Income from Sole Proprietorships	24	12

7. The proposed tax bracket has the potential to raise a significant amount of revenue from a small group of taxpayers, while not affecting the tax liabilities of lower and middle income taxpayers. As indicated in Table 1, only about 1% of all Wisconsin taxpayers would experience a tax increase under the proposal. On the other hand, Tables 3 and 4 indicate that taxpayers reporting the top 1% of the state's taxable income are more likely to receive income from partnerships, S corporations, and sole proprietorships, much of which is from small businesses. A 2008 Small Business Administration report entitled The Small Business Economy indicates that small businesses (fewer than 500 employees) employed 50.4% of the nation's employment in 2005 and that nearly 80% of the country's net new jobs come from small businesses. Consequently, it could

be argued that increasing taxes on this group of taxpayers may suppress that segment of the state's economy that is most likely to assist in the economic recovery.

8. Except for the proposed cigarette tax increase, the two largest general fund tax increases proposed in AB 75 are targeted to upper income taxpayers. Placing a greater reliance on these taxpayers will increase the volatility of individual income tax collections. Relative to other taxpayers, the income of upper income taxpayers is more volatile because a greater percentage is comprised of capital gains and business income, as opposed to wages. Volatility is particularly exhibited during periods of economic contraction and expansion. During the 2001 recession, total taxable income for filers with incomes over $200,000 decreased by 9.0%, while the total taxable income for filers with incomes below $200,000 increased by 0.1%. The total net tax liability for the upper income taxpayers decreased by 9.5% in 2001, while the liability for all other filers decreased by 3.2%. As the economy recovered, the statewide taxable income of taxpayers with incomes above $200,000 increased by 1.3% in 2002, 7.9% in 2003, and 17.0% in 2004, while the statewide taxable income of taxpayers with taxable incomes below $200,000 decreased by 0.8% in 2002 before increasing by 2.7% in 2003 and 4.2% in 2004. Some of the increase in taxable income among upper income taxpayers was due to more taxpayers surpassing the $200,000 income threshold. Those taxpayers increased by 8.6% in 2003 and 11.4% in 2004, after decreasing by 5.1% in 2001 and 2.1% in 2002.

9. Of the 43 states, plus the District of Columbia, that imposed an individual income tax in 2007, seven imposed a flat tax rate on all taxable income ranging from 3.0% in Illinois to 6.0% in Tennessee. The state of Massachusetts had two flat tax rates, each of which was applied to different sources of income. The remaining 36 states and the District of Columbia employed a marginal rate and bracket structure.

10. Among these states, the number of brackets ranged from two in Connecticut to 10 in Missouri. Wisconsin was one of six states that employed four tax brackets, and if the Governor's proposal is adopted, it would be one of seven states with five brackets. In 2007, there were 15 states with more than five tax brackets. The federal individual income tax system consists of six brackets.

11. The income level at which the top tax rate applies varies considerably among the states. At the low end, the top marginal tax rate began at $3,001 for all filing types in Maryland and for all filing types except married-joint filers ($6,001) in Alabama. At the other extreme, New Jersey's top marginal rate began at $500,001 for all filing types. In 2007, Wisconsin's top marginal tax rate applied to income over $142,651 for single and head-of-household filers and $190,211 for married-joint filers. In addition to New Jersey, six states employed a higher threshold for their top marginal tax rate in 2007 (Arizona, North Carolina, North Dakota, Ohio, Rhode Island, and Vermont). If the Governor's recommendation had been in effect in 2007, four states would have had a higher threshold for their top marginal tax rate (New Jersey, North Dakota, Rhode Island, and Vermont).

12. In 2007, the top tax rate ranged from 4.54% in Arizona to 9.9% in Rhode Island. In addition to Rhode Island, three other states had top marginal tax rates of 9.0% or more, and 18 states

employed a top marginal tax rate that was higher than Wisconsin's 6.75% rate. Table 5 displays these states, their top marginal tax rate, and the income threshold for the rate by filing status.

TABLE 5

States with Top Marginal Tax Rates of 6.75% or More in 2007 and the Corresponding Income Bracket

State	Tax Rate	Single	Married-Joint	Married-Separate	Head-of-Household
Wisconsin	6.75%	$142,651	$190,211	$95,101	$142,651
Arkansas	7.00	31,000	31,000	31,000	31,000
California	9.30	44,815	89,629	44,815	61,001
District of Columbia	8.50	40,001	40,001	40,001	40,001
Hawaii	8.25	48,001	96,001	48,001	72,001
Idaho	7.80	24,737	49,473	24,737	49,473
Iowa	8.98	60,436	60,436	60,436	60,436
Maine	8.50	18,950	37,950	18,950	28,450
Minnesota	7.85	69,991	123,751	61,881	105,411
Montana	6.90	14,901	14,901	14,901	14,901
Nebraska	6.84	27,001	54,001	27,001	40,001
New Jersey	8.97	500,001	500,001	500,001	500,001
New York	6.85	20,001	40,001	20,001	30,001
North Carolina	8.00	120,001	200,001	100,001	160,001
Oregon	9.00	7,151	14,301	7,151	14,301
Rhode Island	9.90	349,701	349,701	174,851	349,701
South Carolina	7.00	12,651	12,651	12,651	12,651
Utah	7.00	5,001	11,001	5,001	11,001
Vermont	9.50	349,701	349,701	174,851	349,701

13. Economic conditions are causing other states to consider tax changes like those proposed in AB 75. The current economic contraction began affecting state budgets in FY 2008. Based on a survey of legislative fiscal directors, the National Conference of State Legislatures reports that after states addressed budget gaps totaling $40 billion in FY 2009, additional gaps totaling $62 billion were identified and FY 2010 gaps are estimated at $121 billion. States have employed a variety of responses to these conditions according to the National Governors Association and the National Association of State Fiscal Officers. In The Fiscal Survey of States (December, 2008), those associations report that states have enacted tax and fee increases totaling $4.5 billion in FY 2008 and $1.5 billion in FY 2009. Among six states enacting individual income tax increases in FY 2009, Maryland established a 6.25% bracket on net taxable income over $1 million for tax years 2008 through 2010. Maryland estimates raising $154.6 million in FY 2009 under this provision. An April 9, 2009, Wall Street Journal article reports that ten states, including

Wisconsin, are considering major increases in income or sales taxes and that California and New York lawmakers have enacted increases that went into effect earlier this year.

14. The tax rate proposed in the bill, as well as the existing tax rates, could be modified to raise more or less revenue or to affect taxpayers at different income levels. A change in the lowest tax rate would impact all taxpayers, whereas a change in the top tax rate would only affect those taxpayers with taxable income in the top tax bracket. An across-the-board rate change would affect all taxpayers proportionately to their income.

15. The tax brackets could also be modified. For example, lowering the proposed threshold for the top tax bracket would increase the amount of income tax collections relative to the Governor's proposal, and raising the proposed threshold would reduce collections. Similarly, reducing the income thresholds for the existing tax brackets would increase estimated income tax collections, and increasing the thresholds for the existing tax brackets would reduce estimated income tax collections.

ALTERNATIVES

1. Adopt the Governor's recommendation to create a fifth income tax bracket and extend a rate of 7.75% to income exceeding the threshold for the bracket. Decrease estimated revenues by $12,210,000 in 2009-10 and $12,223,000 in 2010-11 to reflect reduced income tax collections, as indicated by the current economic forecast. Relative to current law, individual income tax collections would increase by an estimated $163,353,000 in 2009-10 and $123,971,000 in 2010-11.

ALT1	**Change to Bill** Revenue
GPR	**-** $24,433,000

2. Modify the Governor's recommendation by changing the tax rate or income thresholds included in the bill.

3. Delete provision.

ALT 3	**Change to Bill** Revenue
GPR	**-** $311,757,000

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