



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #319

Individual Income Tax Rate Reduction Based on Sales Taxes from Out-of-State Retailers (General Fund Taxes -- Income and Franchise Taxes)

[LFB 2019-21 Budget Summary: Page 139, #9]

CURRENT LAW

State law establishes four tax brackets and assigns a marginal tax rate to each bracket. The brackets vary by filing status, and each tax bracket spans a range of taxable income. Each marginal tax rate applies only to income that falls within the corresponding bracket, and a taxpayer's gross tax is the cumulative total tax from each applicable bracket. The tax brackets are indexed annually for changes in inflation, and for tax year 2019, the following rates and brackets apply:

Tax Rate	Income Brackets by Filing Status		
	Single and Head-of-Household	Married Joint	Married Separate
4.00%	\$0 to \$11,760	\$0 to \$15,680	\$0 to \$7,840
5.84	11,760 to 23,520	15,680 to 31,360	7,840 to 15,680
6.27	23,520 to 258,950	31,360 to 345,270	15,680 to 172,630
7.65	258,950 or over	345,270 or over	172,630 or over

For tax year 2019, the preceding rates will be proportionally reduced, so that the lower amount of individual income tax collections will be offset by the additional amount of state sales and use taxes realized from imposing the state sales and use tax on certain remote sellers during the 12-month period between October 1, 2018, and September 30, 2019. Procedures for determining the rate reductions were enacted as part of 2013 Wisconsin Act 20 and modified by 2017 Wisconsin Act 368, so that the Department of Revenue (DOR) determines the amount of sales and use tax reported by out-of-state retailers and the proportional tax rate reductions under the individual income tax and reports those determinations to the Governor, the Secretary of the

Department of Administration (DOA), the Joint Committee on Finance, and the Legislative Audit Bureau (LAB). If the LAB's review of the determinations results in a different calculation of tax rates, the Joint Committee on Finance is required to determine which tax rates apply.

GOVERNOR

Modify the current law provision that requires a reduction in individual income tax rates in tax year 2019 to offset the additional sales and use tax collected from out-of-state retailers during the 12-month period from October 1, 2018, to September 30, 2019, by requiring the rate reduction be made to the lowest individual income tax rate (currently 4.0%), rather than to all four tax rates in proportion to the share of gross tax attributable to each of the four tax brackets established under current law.

DISCUSSION POINTS

1. In 2013, the Wisconsin Legislature recognized the possibility that the U.S. Congress may enact legislation expanding states' ability to require out-of-state sellers to collect and remit sales and use taxes on remote sales to individuals in their state. In response, the Legislature included a provision in 2013 Wisconsin Act 20, the 2013-15 biennial budget act, specifying that any resulting sales and use tax collected on such sales to Wisconsin residents be used first to eliminate the alternative minimum tax (AMT) and then to further reduce income tax rates in proportion to the share of gross tax attributable to each of the tax brackets in effect. The Act charged DOR with determining how much additional sales and use tax was collected from remote sales during the first 12 months following the date on which the state began collecting the tax.

2. On two occasions, the Legislature has modified the Act 20 provision, and in each instance, the Legislature retained the requirement that the rate reductions be in proportion to the share of gross tax attributable to each tax bracket. In 2017 Wisconsin Act 59, the 2017-19 biennial budget, the Legislature adopted a provision eliminating the state AMT, effective in tax year 2019. The AMT reference in the Act 20 provision was removed, and the proportional reduction in income tax rates became the sole use of the sales tax proceeds from remote sales. In the following year, 2017 Wisconsin Act 368 modified the Act 20 provision to accelerate the tax year that the tax rate reductions take effect and to provide additional oversight of DOR's rate reduction calculations, including a role for the Legislature. The Act 368 changes were prompted by the 2018 U.S. Supreme Court decision, *South Dakota v. Wayfair, Inc.*, rather than an act of Congress, allowing states to require out-of-state sellers lacking a physical presence in the state to collect tax on remote sales, so long as the state tax meets certain other requirements. Act 368 specified that the decision triggered the income tax rate reductions.

3. While the Legislature has affirmed its use of proportional tax rate reductions for the sales tax proceeds from remote sales on these occasions, the Legislature has also recently adopted a more targeted tax rate reduction. A year after the Legislature adopted the original requirement that sales tax from remote sales be used to proportionally reduce individual income tax rates, the Legislature enacted an individual income tax rate reduction. In 2013 Wisconsin Act 145, the Legislature adopted

a provision reducing the marginal tax rate that applies to income that falls within the bottom income tax bracket from 4.4% to 4.0%, effective in tax year 2014. The Act did not make changes to the marginal tax rates for the other three income tax brackets.

4. DOR has estimated that \$61.0 million will be available to reduce tax rates in tax year 2019 based on the amount of sales tax collected from remote sellers at the time the biennial budget bill was introduced. Table 1 reports the tax year 2019 tax rate structure for the tax rates that are currently in effect, the estimated tax rates under the Governor's proposal to limit the rate reduction to the bottom tax bracket (bottom bracket), and the estimated tax rates under a reduction in proportion to each bracket's share of gross tax (across-the-board).

TABLE 1

**Individual Income Tax Rates Currently in Effect
and Estimated Tax Rates Under Two Rate Reduction Alternatives**

	Income Tax Rates <u>Currently in Effect</u>	<u>Alternative Tax Rate Reductions</u>	
		<u>Bottom Bracket</u>	<u>Across-the-Board</u>
Bottom Bracket	4.00%	3.78%	3.98%
Second Bracket	5.84	5.84	5.81
Third Bracket	6.27	6.27	6.23
Top Bracket	7.65	7.65	7.61

5. Attachment 1 reports the estimated distribution of taxpayers and net tax by Wisconsin adjusted gross income (AGI) for tax year 2019 under the tax rates currently in effect, before the tax reduction based on the amount of sales tax collected from remote sellers. For tax year 2019, the total amount of net tax is estimated to decrease by \$61.0 million, or 0.7%, from \$8,779.3 million to \$8,718.3 million. Similar attachments were not prepared for the two alternatives because the amount of the tax reduction is not large enough to appreciably change the distribution of taxpayer count or amount of net tax. However, there are some low-income taxpayers who currently have a tax liability, but who would no longer have a tax liability under each alternative. Because there would be fewer taxpayers with a net tax under the alternative that reduces the rate for the bottom bracket, than under the alternative that reduces rates across-the-board, a higher average net tax results under the reduction to the bottom bracket (\$3,809), than under the across-the-board alternative (\$3,800), even though each alternative would reduce taxes by \$61.0 million.

6. Attachment 2 reports the estimated distribution by Wisconsin AGI of taxpayers and tax change among taxpayers with a tax decrease in tax year 2019 under the two tax rate reduction alternatives. Over 95% of all taxpayers with a tax liability and over 70% of all tax filers would experience a tax decrease under each alternative, and no taxpayers would experience a tax increase. The number of taxpayers experiencing a tax decrease is estimated at 2,273,210 under the bottom bracket alternative and at 2,215,020 under the across-the-board alternative. Compared to the bottom bracket alternative, more than 58,000 taxpayers would not experience a tax decrease under the across-the-board alternative. These taxpayers have lower AGIs and their taxable income falls entirely in the

bottom bracket. The estimated change to the 4.0% rate under the across-the-board alternative is so small as to result in no tax change for these taxpayers. Taxpayers with no tax change are likely to be single dependent, nonresident, and part-year resident filers.

7. The distribution of taxpayers with a tax decrease is similar under the two alternatives. While the tax decrease distribution under the bottom bracket alternative is comparable to the taxpayer distributions, the tax decrease distribution under the across-the-board alternative is more heavily weighted towards taxpayers in higher AGI categories. To illustrate, taxpayers with AGI between \$20,000 and \$70,000 would comprise just over 50% of the taxpayers with a tax decrease, and those taxpayers would receive just over 50% of the tax decrease under the bottom bracket alternative. However, taxpayers in that AGI range would receive only 18% of the tax decrease under the across-the-board alternative. The tax decrease distribution under that alternative mirrors the distribution of net tax, as displayed in Attachment 1.

8. Under the rate and bracket structure currently in effect, taxpayers with AGI under \$100,000 represent 78.5% of taxpayers with a net tax and pay 33.5% of the net tax, and taxpayers with AGI over \$100,000 represent 21.5% of the taxpayers with a net tax and pay 66.5% of the net tax. These amounts are displayed in Table 2.

TABLE 2

Distribution of Taxpayers and Net Tax Under Tax Rates Currently in Effect for Taxpayers with AGI Under \$100,000 and Over \$100,000, Tax Year 2019

<u>AGI Group</u>	<u>Count</u>	<u>Taxpayers</u>		<u>Net Tax</u>	
		<u>Percentage</u>	<u>\$(Million)</u>	<u>Percentage</u>	
Under \$100,000	1,802,150	78.5%	\$2,940.0	33.5%	
Over \$100,000	<u>493,680</u>	<u>21.5</u>	<u>5,839.3</u>	<u>66.5</u>	
Total	2,295,830	100.0%	\$8,779.3	100.0%	

9. Under the bottom bracket alternative, taxpayers with an AGI below \$100,000 represent 78.3% of the taxpayers with a tax decrease, and they would receive 73.3% of the estimated tax decrease. Taxpayers with AGI over \$100,000 represent 21.7% of the taxpayers with a tax decrease, and they would receive 26.7% of the estimated tax decrease. Under the across-the-board alternative, taxpayers with an AGI below \$100,000 represent 77.7% of the taxpayers with a tax decrease, and they would receive 32.3% of the estimated tax decrease. Taxpayers with AGI over \$100,000 represent 22.3% of the taxpayers with a tax decrease, and they would receive 67.7% of the estimated tax decrease. These amounts are displayed in Table 3.

TABLE 3

**Distribution of Taxpayers with a Net Tax and a Tax Decrease
for Taxpayers with AGI Under \$100,000 and Over \$100,000
Under Two Tax Rate Reduction Alternatives, Tax Year 2019**

<u>AGI Group</u>	<u>Bottom Bracket</u>		<u>Across-the-Board</u>	
	<u>Percent of Taxpayers</u>	<u>Percent of Tax Decrease</u>	<u>Percent of Taxpayers</u>	<u>Percent of Tax Decrease</u>
Under \$100,000	78.3%	73.3%	77.7%	32.3%
Over \$100,000	<u>21.7</u>	<u>26.7</u>	<u>22.3</u>	<u>67.7</u>
Total	100.0%	100.0%	100.0%	100.0%

10. Under the bottom bracket alternative, taxpayers with AGI below \$100,000 would receive an average tax decrease of \$25, equal to 1.5% of their current tax liability. Taxpayers with AGI above \$100,000 would receive an average tax decrease of \$33, equal to 0.3% of their current net tax liability. Under the across-the-board alternative, taxpayers with AGI below \$100,000 would receive an average tax decrease of \$11, and taxpayers with AGI over \$100,000 would receive an average tax decrease of \$84. The across-the-board alternative would result in a tax decrease equal to 0.7% of each group's current tax. For all taxpayers with a tax decrease, a \$61.0 million tax decrease would produce an average tax decrease of \$27 under the bottom bracket alternative and \$28 under the across-the-board alternative. As a percentage of current tax, the decrease would average 0.7% under each alternative. These amounts are displayed in Table 4.

TABLE 4

**Estimated Average Tax Decrease and Percentage Tax Decrease
for Taxpayers with a Net Tax and with AGI Under \$100,000 and Over \$100,000
Under Two Tax Rate Reduction Alternatives, Tax Year 2019**

<u>AGI Group</u>	<u>Bottom Bracket</u>		<u>Across-the-Board</u>	
	<u>Average Tax Decrease</u>	<u>Percentage Tax Decrease</u>	<u>Average Tax Decrease</u>	<u>Percentage Tax Decrease</u>
Under \$100,000	\$25	1.5%	\$11	0.7%
Over \$100,000	33	0.3	84	0.7
All Taxpayers with a Decrease	\$27	0.7%	\$28	0.7%

11. At the time 2017 Wisconsin Act 368 was enacted, the amended Act 20 provision was expected to reduce tax rates on an ongoing basis beginning in tax year 2019. Reductions of \$60 million were incorporated into the amount of individual income tax collections estimated for 2019-20 and 2020-21 that were reported by this office in its January 30, 2019 revenue estimates, and those amounts were used by the administration to prepare the biennial budget. However, the amended statute reads,

"the new tax rates take effect for the taxable year ending on December 31, 2019" and that the tax rates "apply to the taxable year ending on December 31, 2019." After reviewing the language of Act 368, DOR has indicated that it interprets the law to mean the income tax rate reduction applies to tax year 2019 only. On May 1, 2019, DOA submitted an errata seeking to clarify that the tax rate reduction is ongoing.

12. If the Committee wants the tax rate reduction to apply only in tax year 2019, it could not adopt the errata and either adopt the Governor's proposal to limit the tax rate reduction to the tax rate for the bottom income bracket (Alternative 1) or retain the current law provision reducing each of the four tax rates on an across-the-board basis (Alternative 2).

13. If the Committee believes the Legislature intended the tax rate reduction to be ongoing, rather than apply only in tax year 2019, the Committee could modify the bill to amend the tax rate reduction statute to accomplish this purpose. Because this office reflected the DOR determination in its May, 2019, revenue reestimates, this modification would have the effect of reducing individual income tax collections by over \$60 million in 2020-21. However, making the tax rate reduction ongoing would result in a somewhat different fiscal effect, depending on whether the Committee adopts the Governor's proposed tax rate reduction or retains the tax rate reduction under current law. If the Committee modifies the Governor's proposal to limit the tax rate reduction to the tax rate for the bottom income bracket, a 2020-21 tax decrease estimated at \$63.2 million would result (Alternative 3). If the Committee modifies the across-the-board tax rate reduction authorized under current law, a 2020-21 tax decrease estimated at \$64.7 million would result (Alternative 4).

14. The estimated tax decrease presented in the preceding alternatives totals about \$60 million annually. This amount represents a relatively minor change to the state's individual income tax, which totals about \$9 billion. Instead of using the sales tax proceeds to reduce individual income tax rates, the Legislature could use it to enhance another budget initiative, such as the proposed family and individual reinvestment credit or the proposed child and dependent care credit. If the Legislature wants to pursue more fundamental income tax reform, the tax revenues from this proposal could be combined with revenues associated with other budget provisions, such as those just mentioned, and used to address the marriage penalty, reduce the income range for the third tax bracket, or increase the personal exemption level to adjust tax liabilities in relation to family size. Alternative #5 would repeal the income tax rate reduction requirement, as created by 2013 Act 20 and modified by 2017 Act 368, thereby making the sales tax proceeds from remote sellers available for other uses. This alternative would increase individual income tax collections by an estimated \$61.0 million in tax year 2019 and in fiscal year 2019-20.

ALTERNATIVES

1. Approve the Governor's proposal to modify the current law provision that requires a reduction in individual income tax rates in tax year 2019 to offset the additional sales and use tax collected from out-of-state retailers during the 12-month period from October 1, 2018, to September 30, 2019, by requiring the rate reduction be made only to the lowest individual income tax rate (currently 4.0%). This alternative would not include the errata submitted by DOA to clarify that the tax rate reduction is ongoing.

2. Take no action and retain the current law requirement for an across-the-board reduction in individual income tax rates in tax year 2019.

3. Modify the Governor's proposal to limit the tax rate reduction to the rate for the lowest individual income tax bracket by extending the tax rate determined for tax year 2019 to succeeding tax years. Decrease individual income tax collections in 2020-21 by an estimated \$63,200,000.

ALT 3	Change to	
	Base	Bill
GPR-Tax	-\$63,200,000	-\$63,200,000

4. Modify the current law provision that requires an across-the-board reduction in individual income tax rates by extending the tax rates determined for tax year 2019 to succeeding tax years. Decrease individual income tax collections in 2020-21 by an estimated \$64,700,000.

ALT 4	Change to	
	Base	Bill
GPR-Tax	-\$64,700,000	-\$64,700,000

5. Delete the Governor's recommendation and repeal the current law requirement to reduce individual income tax rates based on the amount of sales tax collected from remote sellers. Increase individual income tax collections under the bill by an estimated \$61,000,000 in 2019-20.

ALT 5	Change to	
	Base	Bill
GPR-Tax	\$61,000,000	\$61,000,000

Prepared by: Rick Olin
Attachments

ATTACHMENT 1

Estimated Distribution of Taxpayers and Net Tax Under Current Tax Rate Schedule Prior to Reduction Related to the Sales Tax Collected from Remote Sellers, Tax Year 2019

<u>Wisconsin Adjusted Gross Income</u>	<u>Count</u>	<u>Percent of Count</u>	<u>Amount of Net Tax</u>	<u>Percent of Net Tax</u>	<u>Average Net Tax</u>	<u>Count of All Returns</u>	<u>% of Returns with Net Tax</u>
Under \$5,000	43,300	1.9%	\$3,661,620	< 0.1%	\$85	472,390	9.2%
5,000 to 10,000	28,050	1.2	6,387,500	0.1	228	220,080	12.7
10,000 to 15,000	77,860	3.4	11,894,980	0.1	153	188,590	41.3
15,000 to 20,000	115,740	5.0	27,707,260	0.3	239	173,680	66.6
20,000 to 25,000	143,140	6.2	54,284,430	0.6	379	171,290	83.6
25,000 to 30,000	152,380	6.6	91,763,370	1.0	602	169,640	89.8
30,000 to 40,000	309,860	13.5	297,265,620	3.4	959	316,190	98.0
40,000 to 50,000	254,340	11.1	392,107,250	4.5	1,542	255,800	99.4
50,000 to 60,000	196,290	8.5	415,271,980	4.7	2,116	197,050	99.6
60,000 to 70,000	155,910	6.8	416,618,200	4.7	2,672	156,370	99.7
70,000 to 80,000	125,760	5.5	406,504,820	4.6	3,232	126,060	99.8
80,000 to 90,000	107,550	4.7	410,624,430	4.7	3,818	107,750	99.8
90,000 to 100,000	91,970	4.0	405,928,910	4.6	4,414	92,090	99.9
100,000 to 125,000	172,420	7.5	931,082,470	10.6	5,400	172,630	99.9
125,000 to 150,000	104,770	4.6	713,679,370	8.1	6,812	104,860	99.9
150,000 to 200,000	100,810	4.4	887,056,330	10.1	8,799	100,950	99.9
200,000 to 250,000	41,850	1.8	491,227,990	5.6	11,738	41,960	99.7
250,000 to 300,000	21,000	0.9	309,767,870	3.5	14,751	21,080	99.6
300,000 to 500,000	29,840	1.3	639,697,160	7.3	21,438	30,220	98.7
500,000 to 1,000,000	15,520	0.7	639,469,730	7.3	41,203	15,660	99.1
1,000,000 and over	<u>7,470</u>	<u>0.3</u>	<u>1,227,264,440</u>	<u>14.0</u>	164,292	<u>7,640</u>	97.8
Total	2,295,830	100.0%	\$8,779,265,730	100.0%	\$3,824	3,141,980	73.1%

- Under the current rate and bracket structure, an estimated 2.3 million taxpayers will incur net tax liabilities estimated at \$8,779.3 million in tax year 2019. An average tax of \$3,824 is estimated.

- Taxpayers with AGI under \$100,000 comprise 78.5% of the taxpayers and pay 33.5% of the net taxes. Their average tax equals \$1,631. Taxpayers with AGI over \$100,000 comprise 21.5% of the taxpayers and pay 66.5% of the net taxes. Their average net tax equals \$11,828.

Based on a simulation of tax year 2019 by the Wisconsin Department of Revenue.

ATTACHMENT 2

Distribution of Taxpayers and Tax Change Among Taxpayers with a Tax Decrease Under Tax Rate Reduction Alternatives, Tax Year 2019

Wisconsin Adjusted Gross Income	Taxpayers with a Tax Decrease Under Tax Rate Reduction Alternatives:				Amount of Tax Decrease Under Tax Rate Reduction Alternatives:				Average and Percentage Tax Decrease Under Tax Rate Reduction Alternatives:			
	Bottom Bracket		Across-the-Board		Bottom Bracket		Across-the-Board		Bottom Bracket		Across-the-Board	
Under \$5,000	30,170	1.3%	18,160	0.8%	-\$82,660	0.1%	-\$20,370	< 0.1%	-\$3	-2.3%	-\$1	-0.6%
5,000 to 10,000	25,320	1.1	20,750	0.9	-147,290	0.2	-37,160	0.1	-6	-2.3	-2	-0.6
10,000 to 15,000	73,580	3.2	35,770	1.6	-413,000	0.7	-66,050	0.1	-6	-3.5	-2	-0.6
15,000 to 20,000	115,050	5.1	111,420	5.0	-1,522,580	2.5	-182,210	0.3	-13	-5.5	-2	-0.7
20,000 to 25,000	142,700	6.3	141,340	6.4	-3,161,980	5.2	-351,590	0.6	-22	-5.8	-2	-0.6
25,000 to 30,000	152,200	6.7	152,220	6.9	-3,659,490	6.0	-579,570	0.9	-24	-4.0	-4	-0.6
30,000 to 40,000	309,590	13.6	309,860	14.0	-8,191,180	13.4	-1,868,480	3.1	-26	-2.8	-6	-0.6
40,000 to 50,000	254,170	11.2	254,340	11.5	-7,096,360	11.6	-2,522,040	4.1	-28	-1.8	-10	-0.6
50,000 to 60,000	196,180	8.6	196,290	8.9	-5,636,780	9.2	-2,742,410	4.5	-29	-1.4	-14	-0.7
60,000 to 70,000	155,820	6.9	155,910	7.0	-4,633,920	7.6	-2,817,740	4.6	-30	-1.1	-18	-0.7
70,000 to 80,000	125,700	5.5	125,760	5.7	-3,862,620	6.3	-2,798,920	4.6	-31	-1.0	-22	-0.7
80,000 to 90,000	107,500	4.7	107,550	4.9	-3,390,130	5.6	-2,858,250	4.7	-32	-0.8	-27	-0.7
90,000 to 100,000	91,930	4.0	91,970	4.2	-2,957,750	4.8	-2,852,050	4.7	-32	-0.7	-31	-0.7
100,000 to 125,000	172,340	7.6	172,420	7.8	-5,655,030	9.3	-6,660,030	10.9	-33	-0.6	-39	-0.7
125,000 to 150,000	104,710	4.6	104,770	4.7	-3,478,270	5.7	-5,151,920	8.4	-33	-0.5	-49	-0.7
150,000 to 200,000	100,750	4.4	100,810	4.6	-3,353,130	5.5	-6,363,210	10.4	-33	-0.4	-63	-0.7
200,000 to 250,000	41,810	1.8	41,850	1.9	-1,387,140	2.3	-3,484,450	5.7	-33	-0.3	-83	-0.7
250,000 to 300,000	20,970	0.9	21,000	0.9	-693,550	1.1	-2,175,990	3.6	-33	-0.2	-104	-0.7
300,000 to 500,000	29,790	1.3	29,840	1.3	-978,080	1.6	-4,334,950	7.1	-33	-0.2	-145	-0.7
500,000 to 1,000,000	15,490	0.7	15,520	0.7	-504,100	0.8	-4,121,440	6.8	-33	-0.1	-266	-0.6
1,000,000 and over	<u>7,440</u>	<u>0.3</u>	<u>7,470</u>	<u>0.3</u>	<u>-236,250</u>	<u>0.4</u>	<u>-9,059,420</u>	<u>14.8</u>	-32	> -0.1	-1,213	-0.7
Total	2,273,210	100.0%	2,215,020	100.0%	-\$61,041,290	100.0%	-\$61,048,250	100.0%	-\$27	-0.7%	-\$28	-0.7%

- The number of taxpayers experiencing a tax decrease is estimated at 2,273,210 under the alternative to reduce the rate for the bottom tax bracket and at 2,215,020 under the alternative to reduce rates across-the-board. The difference is concentrated among taxpayers with lower AGIs whose income is entirely taxed in the bottom tax bracket. The estimated change to the 4.0% rate under the across-the-board alternative is so small as to result in a tax change of less than \$1. The rest of the difference is due to taxpayers filing nonresident and part-year resident returns. Over 95% of all taxpayers with a tax liability and over 70% of all tax filers would experience a tax decrease under each of the two alternatives.

- The total tax decrease is estimated at \$61.0 million and would result in an average tax decrease of \$27 under the alternative lowering the rate for the bottom bracket and \$28 under the alternative lowering the rates on an across-the-board basis, with the number of taxpayers receiving a tax decrease responsible for the difference. The average tax decrease is estimated at 0.7% under each alternative.

Based on a simulation of tax year 2019 by the Department of Revenue.