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Overview of Broad-Based Income and Franchise Tax Reductions (General Fund Taxes -- Income and Franchise Taxes)

CURRENT LAW

Individual Income Tax

The state individual income tax is the major source of general fund tax revenue in Wisconsin. In fiscal year 2021-22, individual income tax collections totaled $9.21 billion and comprised nearly 45% of state general fund tax revenue.

There are several steps involved in calculating state individual income tax liability. In brief, these steps are to: (a) determine Wisconsin adjusted gross income (AGI); (b) subtract the state's sliding scale standard deduction (SSSD) and personal exemptions from AGI to determine Wisconsin taxable income; (c) apply the state's tax rate and bracket schedule to taxable income to find the gross tax amount; (d) subtract applicable nonrefundable state tax credits from the gross tax amount to arrive at net tax liability; and (e) subtract relevant refundable state tax credits from net tax liability to arrive at total tax liability.

Table 1 displays the parameters of the SSSD under current law for tax year 2023. Each tax year, the parameters of the SSSD are indexed for inflation based on the change in the consumer price index for all urban consumers, U.S. city average (CPI-U) from August of the previous year over August of a specified base year, provided the adjustment yields a positive number.

TABLE 1

Current Law Sliding Scale Standard Deduction, Tax Year 2023

Marital Status	Wisconsin AGI	Standard Deduction
Single	Less than $18,400	$12,760
	$18,400 to $124,733	$12,760-12.0% (WAGI-$18,400)
	Greater than $124,733	$0
Married, Joint	Less than $26,550	$23,620
	$26,550 to $145,976	$23,620-19.778% (WAGI-$26,550)
	Greater than $145,976	$0
Married, Separate	Less than $12,600	$11,220
	$12,600 to $69,330	$11,220-19.778% (WAGI-$12,600)
	Greater than $69,330	$0
Head-of-Household	Less than $18,400	$16,480
	$18,400 to $53,778	$16,480-22.515% (WAGI-$18,400)
	Greater than $53,778	Single Standard Deduction

Since tax year 2001, a personal exemption of $700 is provided for each taxpayer, their spouse (if filing married-joint) and each of a taxpayer's qualifying dependents. An additional $250 exemption is provided for each taxpayer (and each spouse if a married-joint filer) who has reached the age of 65 by the close of the relevant tax year (elderly exemption).

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. The brackets have been adjusted for inflation since tax year 1999 in the same manner as the SSSD. 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. Table 2 shows the tax rate and bracket schedules for tax year 2023. Tax tables prepared by DOR simplify the tax calculation process by allowing taxpayers to look up their taxable income and find the gross tax amount that corresponds to that income level.

TABLE 2

Current Law Individual Income Tax Rate and Bracket Schedule, Tax Year 2023

	Income Tax Brackets by Filing Status		
Tax Rate	Single and Head-of-Household	Married-Joint	Married-Separate
3.54%	$0 to $13,810	$0 to $18,420	$0 to $9,210
4.65%	13,810 to 27,630	18,420 to 36,840	9,210 to 18,420
5.30%	27,630 to 304,170	36,840 to 405,550	18,420 to 202,780
7.65%	304,170 and over	405,550 and over	202,780 and over

Corporate Income/Franchise Tax

Wisconsin has both a corporate income tax and a corporate franchise tax. Generally, companies having any intrastate business are subject to the franchise tax, while those having only interstate business here are subject to the income tax. In 2021-22, the corporate income/franchise tax was the state's third largest source of revenue, collecting $2.96 billion (14.4% of general fund revenues).

A corporation determines state corporate income/franchise tax liability by computing gross or total income, subtracting deductions, apportioning the net income to the state (if necessary), adjusting for nonapportionable income and net operating losses (if applicable), applying the 7.9% state tax rate, and subtracting tax credits.

Provisions of 2017 Act 368 allow tax-option (S) corporations and partnerships to elect, via persons holding more than 50% of the shares or capital and profits of a partnership, to be taxed at the entity level (reported under corporate tax collections) rather than generally requiring income to be passed through to their respective owners, members, or shareholders (reported under the individual income tax). Both the corporate income/franchise tax rate and the tax rate on pass-through entities (PTE) of 7.9% exceed the highest individual income tax rate (7.65%) by 0.25 basis points.

Federal Law under the American Rescue Plan Act of 2021

Provisions of the American Rescue Plan Act of 2021 (APRA) amended the Social Security Act to create the state fiscal recovery fund (SFRF) to distribute funding to states. The SFRF provided Wisconsin with more than $2.5 billion in funding. ARPA enumerated various allowable uses of this funding, such as assistance to small businesses, industries, and households to respond to the COVID-19 public health emergency. States must fully obligate their SFRF allocation by December 31, 2024, and the funds must be fully expended by December 31, 2026. Any funds that have not been obligated or expended by those dates must be returned to the U.S. Department of Treasury (Treasury).

ARPA restricted the use of SFRF moneys such that states may not use them to either directly or indirectly offset a reduction in net tax revenue by way of a change in law, regulation, or administrative interpretation that reduces any tax by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise. States in violation of this requirement must repay SFRF moneys to Treasury in the amount of the reduction in net tax revenue, but not exceeding the amount of SFRF funds received. The state Department of Administration (DOA) reports to Treasury the net revenue reduction of covered tax changes and the eligible uses for the SFRF monies allocated to Wisconsin.

DISCUSSION POINTS

1. This paper presents information for consideration of broad-based income and franchise tax relief by modifying the standard deduction, personal exemptions, the individual income tax rate and bracket structure, and the corporate income/franchise tax rate. The fiscal effects shown on Tables 5 and 6 assume each tax reduction would take effect in tax year 2023. The individual income tax

estimates do not assume a withholding table update in conjunction with the tax law change.

Individual Income Tax

2. Table 3 displays possible parameters of an expanded SSSD relative to current law. The maximum deduction amount would be increased by: (a) $5,000 for single and head-of-household filers; (b) $6,500 for married-joint filers; and (c) $3,250 for married-separate filers. The income amount at which the maximum deduction begins to phase out would be increased by 25% for each filing status.

TABLE 3

Modify Sliding Scale Standard Deduction, Tax Year 2023

Marital Status	Wisconsin AGI	Standard Deduction
Single	Less than $23,000	$17,760
	$23,000 to $171,000	$17,760-12.0% (WAGI-$23,000)
	Greater than $171,000	$0
Married, Joint	Less than $33,188	$30,120
	$33,188 to $185,478	$30,120-19.778% (WAGI-$33,188)
	Greater than $185,478	$0
Married, Separate	Less than $15,750	$14,470
	$15,750 to $88,912	$14,470-19.778% (WAGI-$15,750)
	Greater than $88,912	$0
Head-of-Household	Less than $23,000	$21,480
	$23,000 to $58,378	$21,480-22.515% (WAGI-$23,000)
	Greater than $58,378	Single Standard Deduction

3. An alternative method to expand the standard deduction would be to replace the SSSD with the federal standard deduction, the parameters of which are displayed in Table 4. The additional exemption amount shown in Table 4 for taxpayers aged 65 or over would replace the elderly exemption under current state law (the higher amount of $1,850 is available to taxpayers who are unmarried and are not a surviving spouse). In contrast to the SSSD, the federal standard deduction is available to all taxpayers regardless of income, and the deduction amount does not vary based on income. However, the inflation factor for the federal deduction is based on the chained CPI, which generally produces smaller annual increases than the CPI-U (used for the state deduction).

TABLE 4

Current Law Federal Standard Deduction, Tax Year 2023

Filing Status	Single	Married-Joint	Head-of-Household	Married-Separate	Single-Dependent	Age 65 or Blind
Standard Deduction	$13,850	$27,700	$20,800	$13,850	$1,250*	$1,500/$1,850

* For single-dependent filers, the standard deduction equals the greater of $1,250 or the sum of $400 and the individual's earned income.

4. It should be noted that the federal standard deduction amounts in Table 4 represent a temporary expansion of the deduction for tax years 2018 through 2025. Pursuant to the federal Tax Cuts and Jobs Act of 2017, the standard deduction expansion was passed in conjunction with elimination of federal personal exemptions and curtailments to various itemized deductions. These temporary changes are scheduled to sunset after tax year 2025. If the Legislature were to federalize the state standard deduction, and if this sunset occurs, the Legislature would be required to decide for tax years 2026 and thereafter whether to decouple from federal law and continue providing the expanded federal standard deduction, or remain federalized and revert to the non-expanded amounts.

5. Personal exemptions are provided to account for taxpayer differences in family size. The $700 personal exemption amount could be increased by $100, and the elderly exemption could be increased proportionally (by $35). Alternatively, the $700 personal exemption and $250 elderly exemption amounts could be doubled (to $1,400/$500) or tripled (to $2,100/$750).

6. In recent years, the Legislature has considered and enacted broad-based tax relief via several individual income tax rate reductions. For example, beginning in tax year 2019, the rate for the second lowest tax bracket was reduced under 2019 Act 9 (the 2019-21 biennial budget bill) from 5.84% to 5.21%. Under 2019 Act 10, the rates for the two lowest tax brackets were reduced based on state sales tax revenues generated from remote sellers. Act 10 reduced the two lowest rates in tax year 2019 from 4.00% to 3.86% and from 5.21% to 5.04%, and in tax year 2020 to 3.54% and 4.65%, respectively. The rate for the third bracket was lowered under 2021 Act 58 (the 2021-23 biennial budget bill) from 6.27% to 5.30%, beginning in tax year 2021.

7. There exist numerous ways to reduce the individual income tax rate and bracket schedule shown in Table 2. Among these are to: (a) reduce each rate; (b) effectively collapse a bracket by lowering the associated tax rate to be equal to the rate for the next lowest bracket; and (c) expand the taxable income amounts which apply to a bracket. Table 5 includes the fiscal impact of several potential options for providing tax relief by modifying the rate and bracket schedule in these ways ("M-J" in the table refers to married-joint filers). The table also displays the estimated fiscal impact of the potential changes to the SSSD and personal exemptions described above.

TABLE 5

Estimated Fiscal Effect of Various Individual Income Tax Reductions,
Beginning in Tax Year 2023
(Millions)

Provision	2023-24	2024-25	2023-25 Biennial Total
Options for Standard Deduction Changes			
Expand SSSD	$538.5	$544.9	$1,083.4
Federalize Standard Deduction	1,224.8	1,261.9	2,486.7
Options for Personal Exemption Changes			
Increase Personal Exemption by $100	24.5	23.6	48.1
Double Personal Exemption	170.1	163.8	333.9
Triple Personal Exemption	337.3	324.9	662.2
Options for 0.25 Basis Point Rate Reductions			
Reduce 3.54% Rate to 3.29%	87.4	88.2	175.6
Reduce 4.65% Rate to 4.40%	73.3	73.7	147.0
Reduce 5.30% Rate to 5.05%	284.0	284.3	568.3
Reduce 7.65% Rate to 7.40%	74.5	67.9	142.4
Reduce Each Rate by 0.25 Basis Points	537.6	514.0	1,051.6
Options for 0.50 Basis Point Rate Reductions			
Reduce 3.54% Rate to 3.04%	174.6	176.2	350.8
Reduce 4.65% Rate to 4.15%	146.6	147.4	294.0
Reduce 5.30% Rate to 4.80%	567.7	568.1	1,135.8
Reduce 7.65% Rate to 7.15%	149.0	135.9	284.9
Reduce Each Rate by 0.50 Basis Points	1,074.3	1,027.0	2,101.3
Options for Reducing the Number of Tax Brackets			
Collapse 4.65% Bracket into 3.54%	325.2	327.1	652.3
Collapse 5.30% Bracket into 4.65%	737.6	738.3	1,475.9
Collapse 7.65% Bracket into 5.30%	730.4	637.3	1,367.7
Options to Expand Bracket Widths			
Expand 4.65% Bracket by $50,000 M-J*	343.6	343.2	686.8
Expand 5.30% Bracket by $50,000 M-J*	45.0	41.0	86.0
Expand 4.65% Bracket by $100,000 M-J*	522.3	521.4	1,043.7
Expand 5.30% Bracket by $100,000 M-J*	81.2	73.8	155.0

*For all other filing statuses, the brackets would be expanded by the same ratio to M-J as exists under current law (Single/Head-of-Household = 75% of M-J, and Married-Separate = 50% of M-J).

Corporate Income/Franchise Tax

8. Under current law, the 7.9% corporate income franchise tax rate exceeds the tax rate applicable to the highest individual income tax bracket (7.65%) by 0.25 basis points. As a result, C corporations and PTE filers are subject to a higher tax rate relative to businesses subject to the individual income tax (such as sole proprietors and pass-through entities that do not elect to file under the PTE tax). Table 6 shows the estimated revenue impact under the corporate income/franchise tax

of three different rate reductions which would lower the rate from 7.9% to: (a) 7.65%; (b) 7.40%; and (c) 7.15%. These corporate rate reductions include the rate for domestic insurance companies and pass-through entities electing to file at the entity level.

TABLE 6

Estimated Fiscal Effect of Corporate Rate Reductions, Beginning in Tax Year 2023 (Millions)

Tax year 2023 Rate Reduction	2023-24	2024-25	2023-25 Biennium
0.25 Basis Points (to 7.65%)	-$108.3	-$89.9	-$198.2
0.50 Basis Points (to 7.40%)	-216.5	-179.7	-396.2
0.75 Basis Points (to 7.15%)	-324.8	-269.6	-594.4

ARPA - Net Tax Reduction

9. The ARPA offset and recoupment requirements apply only to SFRF monies distributed to the states and do not apply to local units of government or other supplemental federal funds. According to Treasury guidance, for purposes of the offset and recoupment provisions, "tax revenue" does not include revenue taxed and collected by a local unit of government. As a result, the use of state funding to reduce local taxes (such as real or personal property tax) is not relevant for the offset and recoupment provisions (except in the case of funding transferred from the Local Fiscal Recovery Fund to the state).

10. The covered period under ARPA begins on March 3, 2021 and ends on the last day of the state fiscal year in which all SFRF funds have been expended or returned to, or recovered by, Treasury. Because all funds must be expended by December 31, 2026 (or will be returned to Treasury), the offset and recoupment provisions apply at the latest to the 2026-27 fiscal year. The provisions will cease applying for Wisconsin purposes as of the last day of the fiscal year in which all SFRF funds have been expended. In March, 2023, DOA reported to Treasury that the state had obligated $2.1 billion of the $2.5 billion SFRF funds and had expended $1.2 billion. Thus, the covered period will include 2023-24 (and likely 2024-25). It is not known when the Administration will have obligated and expended the last remaining SFRF funds.

11. Treasury implemented a final rule that sets out a procedure to determine whether a state has inappropriately used SFRF funds to offset a reduction in net tax revenue. The analysis is backward looking, such that violations would be reported after tax revenues are collected and expenditures are made.

As described in further detail in the Attachment, if certain law changes reduce revenue compared to inflation-adjusted 2018-19 baseline revenues by more than a de minimis amount (1% of the baseline revenues), then the net reduction in tax revenues are considered to be in violation of the offset provision unless the state identifies countervailing increases in revenue or spending reductions. Under the rule, the amount of SFRF monies to be recouped is limited to at the lesser of: (a) the reduction in net tax revenue (measured as the difference between the baseline and actual revenue as

of the end of the reporting year); or (b) the aggregate amount of reductions in tax revenues caused by covered changes minus the sum of: (i) reductions in spending compared to the inflation adjusted 2018-19 baseline (net of SFRF funds); and (ii) increases in revenue from other covered changes in law.

12. DOA is responsible for reporting SFRF-related expenditures under ARPA to Treasury. In a memorandum dated June 2, 2023, DOA informed the Governor and the DOA Secretary that "the state may reduce taxes and fees by $256 million in fiscal year 2023-24 and $458 million in fiscal year 2024-25 before any federal SFRF monies may be subject to possible recoupment" under current estimates.

13. Based on the DOA estimates, any covered law change that reduces state tax revenues by more than $256 million in fiscal year 2023-24 or $458 million in fiscal year 2024-25 could potentially be subject to recoupment under ARPA unless the state can identify a similar-sized change in law that increases state revenue or decreases spending relative to the inflation-adjusted 2018-19 baseline. The DOA memorandum did not indicate baseline expenditures for 2018-19, which are needed to determine amounts that could be subject to recoupment.

DOA's estimate does not adjust baseline revenues after 2018-19 to account for the phase in of fiscal effects of exempt law changes that are not covered under the ARPA recoupment provision for various reasons, such as being enacted prior to the covered period or federalizing state law. In January, 2023, this Office sought clarification from Treasury whether baseline revenues should reflect exempt changes in law, but Treasury has not yet responded.

14. On May 15, 2023, this office distributed estimates of general fund revenues and expenditures for the 2022-23 fiscal year and tax collection projections for the 2023-25 biennium in which it was estimated that the net general fund balance at the end of 2022-23 would be $6.78 billion. This amount significantly exceeds all SFRF monies received ($2.53 billion), such that state funding could be reasonably identified to offset a tax reduction rather than federal funding.

However, DOA's memorandum stated the agency's belief that "Treasury's Final Rules do not support the inclusion of the state's current general fund surplus as available for covered tax reductions without risking recoupment by Treasury under the federal tax offset provision." DOA has not indicated whether this belief has been confirmed by Treasury. In January, 2023, this Office sought clarification from Treasury whether the utilization of an opening balance would be considered sufficient to avoid recoupment under ARPA, but Treasury has not yet responded.

In addition to the general fund opening balance, the state also maintains a budget stabilization fund consisting primarily of excess state revenues over budgeted amounts. As of the end of May, 2023, the fund had a cash balance of $1.79 billion.

15. It remains unclear whether the recoupment provision under ARPA is enforceable at all. In January, 2023, the Eleventh Circuit Court of Appeals affirmed a lower court's order enjoining enforcement of the tax offset and recoupment provisions against 13 states (*West Virginia v. U.S. Dept. of Treasury*). In Wisconsin, the Joint Committee of Legislative Organization sought to intervene in that case on May 12, 2021, but its participation was denied because the court found that the Wisconsin Department of Justice (DOJ) was the proper entity to represent the state's interest (DOJ declined to

join the case). Thus, Wisconsin, which is located within the appellate jurisdiction of the Seventh Circuit Court of Appeals, was not a plaintiff in the case and the court order does not directly prevent enforcement as to this state. The case has not yet been appealed to the Supreme Court.

The U.S. Supreme Court is considering whether to accept review of another case challenging the constitutionality of the ARPA offset and recoupment provisions [*Ohio v. Yellen*]. The district court granted a permanent injunction from enforcing the offset and recoupment provisions on the grounds that they were unconstitutionally ambiguous. The Sixth Circuit Court of Appeals vacated the injunction and reserved on jurisdictional grounds, not reaching the merits of the constitutional issues raised.

16. Most states have recently enacted legislation with significant decreases to state revenues, including 13 states that enacted reductions in personal or corporate income tax rates in 2021 and 14 states that did so in 2022. This includes Iowa, one of the states for which enforcement of the recoupment provision has been enjoined, which lowered its individual income tax rates (phasing down from nine graduated rates of 0.33% to 8.53% to a single 3.9% rate over several years through 2026), among other changes. Eight states have enacted individual and/or corporate tax rate reductions so far in 2023, with several others in the process of addressing tax reduction legislation for 2023 and 2024. To date, this office is not aware of any state determined to be in violation of the Treasury rule and subject to recoupment of federal SFRF funds.

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ATTACHMENT

Treasury Rule - Offset of a Reduction in Net Tax Revenue

Treasury sets out a four step procedure to determine whether a state has inappropriately used SFRF funds to offset a reduction in net tax revenue [*See* 31 CFR § 35.8]. The analysis is backward looking. Violations are reported after tax revenues are collected.

First, each reporting year, the state identifies all covered changes assessed to have had or predicted to have the effect of reducing tax revenue relative to current law and estimates their aggregate impact. *Covered change* means a change in law, regulation, or administrative interpretation. A change in law includes any final legislative or regulatory action, a new or changed administrative interpretation, and the phase-in or taking effect of any statute or rule if the phase-in or taking effect was not prescribed prior to the start of the covered period. States may not use dynamic scoring to incorporate the macroeconomic impact of the changes (e.g., a tax cut could result in additional economic activity which would increase revenue collections to partially offset the revenue loss).

Second, if the aggregate amount of the changes are de minimis, the state does not have to identify any sources of funding to "pay" for the revenue reduction. That is, the aggregate amount of the measured or predicted reductions in tax revenue caused by covered changes is measured against 1 percent of the State’s or Territory’s baseline. Treasury defines "baseline" to mean the tax revenue for the state's fiscal year ending in 2019, adjusted for inflation in each reporting year using the Bureau of Economic Analysis' (BEA) implicit price deflator for the gross domestic product (GDP) of the United States. If the aggregate change is less than 1% of this baseline, the analysis ends and the state will not be subject to recoupment (i.e., still a violation of the offset provision, but not large enough to trigger recoupment of funds).

Third, the state reports to Treasury the reduction in net tax revenue for the reporting year, measured as the difference between actual tax revenue and the baseline (which is adjusted for inflation). *Tax Revenue* is defined as the revenue received from a compulsory contribution that is exacted by a government for public purposes excluding refunds, corrections, and intergovernmental transfers. Tax revenue does not include payments for a special privilege granted or service rendered, employee or employer assessments and contributions to finance retirement and social insurance trust systems, or special assessments to pay for capital improvements. If actual tax revenue is greater than the baseline, there is no net reduction in tax, and hence no violation of the offset provision.

Fourth, the state compares the net revenue reduction to other changes, including the sum of certain revenue increases and spending reductions not replaced by SFRF moneys. The revenue increases must be caused by covered changes (such as a change in law), as measured by reasonable statistical methodologies (not including dynamic scoring) or based on projections that use reasonable assumptions. The net reduction in total spending is measured as the state's total spending for a given reporting year excluding its spending of SFRF funds, subtracted from its total

spending for its fiscal year ending in 2019, adjusted for inflation using the BEA's implicit price deflator for the GDP of the United States for that reporting year.

ARPA sets out that the amount subject to recoupment is the lesser of the amount of the applicable reduction to net tax revenues attributable to the violation and the amount of funds received under the SFRF (or transferred under the local fiscal recovery fund). The Treasury final rule further clarifies a revenue reduction cap such that, if found in violation of the offset provision, the amount used in violation is equal to the lesser of: (a) the difference between the baseline and actual revenue as of the end of the reporting year; and (b) the aggregate amount of reductions in tax revenues caused by covered changes, minus the sum of (i) reductions in spending compared to the inflation-adjusted 2018-19 baseline (net of SFRF funds); and (ii) increases in revenue from other covered changes in law. As a result, net revenue growth since 2018-19 effectively offsets the cost of the revenue reduction.