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Fiscal Fact

June 3, 2013
No. 372

Wisconsin Plan Cuts Rates, Broadens Bases, Improves State Business Tax Climate

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On May 28, Wisconsin Representative Dale Kooyenga introduced a bill that reforms numerous elements of Wisconsin's tax code. These reforms would improve the state's ranking in the *State Business Tax Climate Index*,[1] which annually compares the states' tax systems on over 100 variables that impact business. If enacted, the plan would move Wisconsin out of the bottom ten states. Representative Kooyenga's proposal expands on Governor Walker's income tax cut which is currently written into the budget being considered, simplifies the code, makes it more neutral to different types of business activity, and trims several odds and ends that have persisted for decades. The result is an *Index* ranking of 40, up from the current ranking of 43.

A full list of provisions is found in the bill's legislative note,[2] but major provisions would:

Table 1: Individual Income Taxes under Representative Kooyenga's Plan

Current Law			Governor's Plan			Kooyenga's Plan in 2015		
4.60%	>	$0	4.60%	>	$0	4.50%	>	$0
6.15%	>	$14,510	5.94%	>	$14,510	5.94%	>	$14,510
6.50%	>	$29,020	6.36%	>	$29,020	7.60%	>	$319,460
6.75%	>	$217,630	6.75%	>	$217,630			
7.75%	>	$319,460	7.75%	>	$319,460			

*Rates given are for married joint filers

- Reduce income tax rates across the board, while reducing the number of brackets from five to three by 2015 (see Table 1);
- Eliminate the Alternative Minimum Tax starting in tax year 2013;
- Sunset defunct provisions relating to the now-extinct estate tax "pick-up" credit;
- Recouple depreciation and depletion schedules to the federal standard;
- Eliminate or reduce several distortionary business tax credits, with major changes that would:
    - Eliminate the jobs credit
    - Make credits for research and development available to passthroughs for 2013, but then repeal the research facilities credit in 2014
    - Eliminate film tax credits
    - Limit the manufacturing and agricultural tax credit

[1] *See* Scott Drenkard & Joseph Henchman, *2013 State Business Tax Climate Index*, TAX FOUNDATION BACKGROUND PAPER NO. 64 (Oct. 9, 2012), http://taxfoundation.org/article/2013-state-business-tax-climate-index.
[2] Wisconsin Legislative Fiscal Bureau, Memorandum from Bob Lang, Director, to Representative Dale Kooyenga describing Representative Kooyenga's proposed budget amendment and its fiscal effects, May 28, 2013, http://www.thewheelerreport.com/wheeler_docs/files/0529kooyenga.pdf.

- Increase the cap on capital losses from $500 to conform to the federal $3,000; and
- A stipulation that any additional sales tax revenue generated as a result of federal legislation creating a new internet sales tax regime is used to lower the state's individual income tax rates.

These changes improve Wisconsin's score in our *State Business Tax Climate Index*, in both the state's overall scores and numerous subscores. Table 2 outlines these score improvements.

Table 2: *State Business Tax Climate Index* Scores under Representative Kooyenga's Plan

	Current Law	Representative Kooyenga's Plan
Overall	43	40
Corporate	32	26
Individual	46	45
Sales	15	15
Unemployment Insurance	23	23
Property	33	33

Income Taxes and Economic Growth

While political voices often have robust disagreements about the level of services that governments ought to provide, the academic literature speaks virtually in unison on the relationship between tax rates and economic growth. Of the 26 peer-reviewed studies on the topic, 23 find a negative relationship between taxes and growth. Additionally, all of the studies in the past 15 years support that conclusion.

Of the studies that distinguish between different types of taxes, corporate and individual income taxes are found to harm growth most, while sales and property taxes are found to hurt growth least.[3] This finding makes logical sense as well; taxes on income disincentivize value creation, whereas sales taxes are levied at the point of consumption, meaning in a relative sense that they incentivize savings. Savings, in turn, is associated with long run economic growth because people and businesses purchase capital from savings.

Progressive income taxes have been found by economists to be distortive to the labor market as well. Edward Prescott found that income taxes in Europe over 1950-2000 reduced the number of hours worked by employees,[4] and Jens Arnold found that progressive tax structures harm growth.[5] Elimination of the Alternative Minimum Tax further removes negative work incentives and greatly simplifies the tax code.

Plan Limits or Eliminates Distortionary Business Tax Credits

This plan aims to trim a few distortionary tax credits in the corporate income tax code, including the credit for job creation. While such tax preferences can be politically expedient because they ostensibly incentivize new jobs, their effect on the economic playing field is damaging.

Tax credits are economically equivalent to subsidies because they place certain businesses on an elevated platform above their competition. In the prospect of tax reform, retaining credits implicitly means that rates on any non-favored business must be higher. One of the best studies for illuminating this fact finds that

[3] William McBride, *What Is the Evidence on Taxes and Growth?*, TAX FOUNDATION SPECIAL REPORT NO. 207 (Dec. 18, 2012), http://taxfoundation.org/article/what-evidence-taxes-and-growth.

[4] Edward C. Prescott, *Why Do Americans Work So Much More than Europeans?*, 28 FEDERAL RESERVE BANK OF MINNEAPOLIS QUARTERLY REVIEW 2-13 (2004), http://www.minneapolisfed.org/research/QR/QR2811.pdf.

[5] Jens Arnold, *Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries*, OECD ECONOMICS DEPARTMENT WORKING PAPERS NO. 643 (2008).

most studies examining the effectiveness of incentives do not have a method for accounting for opportunity cost, where the money might have been spent elsewhere.[6] Ideally, the credit should be closed and the revenue put toward lowering the overall rate. The case against tax credits is especially strong for film production incentives, which have additionally been shown to be associated with abuse and fraud, in addition to failing to generate economic benefits that exceed their costs.[7] The trend in many states is toward reducing or eliminating their programs.[8]

Internet Sales Tax Provision Protects Against Revenue Spike

Boatloads of ink have been spilled over the problems with state collection of internet sales taxes.[9] One of the persistent claims that this plan addresses is that the new taxes collected as a result of federal legislation would be a windfall for state governments that they would in turn spend. Representative Kooyenga's plan addresses this concern by devoting any additional tax revenue from a federal internet sales tax solution to lowering state income tax rates, shifting burdens in the long run toward a more pro-growth, consumption-based system.

Conclusion

To be sure, more needs to be done to remove problems in the Wisconsin tax code, but this plan is a concerted step in the right direction. It would remove some of the special treatment of certain businesses (which comes with the cost of higher overall rates), and cuts income taxes across the board.

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About the Tax Foundation
The Tax Foundation is a 501(c)(3) non-partisan, non-profit research institution founded in 1937 to educate the public on tax policy. Based in Washington, D.C., our economic and policy analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability.

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[6] Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location Decisions: An Overview of the Literature*, 1 ECONOMIC DEVELOPMENT QUARTERLY 90-105 (2001).
[7] *See* Mark Robyn, *Film Production Incentives: a Game California Shouldn't Play (Testimony before California Legislature)*, Mar. 21, 2011, http://taxfoundation.org/article/film-production-incentives-game-california-shouldnt-play-testimony-california-legislature.
[8] *See* Joseph Henchman, *More States Abandon Film Tax Incentives as Programs' Ineffectiveness Becomes More Apparent*, TAX FOUNDATION FISCAL FACT NO. 272, (June 2, 2011), http://taxfoundation.org/article/more-states-abandon-film-tax-incentives-programs-ineffectiveness-becomes-more-apparent. *See also* Will Luther, *Movie Production Incentives & Film Tax Credits: Blockbuster Support for Lackluster Policy*, TAX FOUNDATION SPECIAL REPORT NO. 173 (Jan. 14, 2010), http://taxfoundation.org/article/movie-production-incentives-film-tax-credits-blockbuster-support-lackluster-policy.
[9] For a primer, *see* Joseph Henchman, *Testimony on the Proper Role of Congress in State Taxation*, Apr. 25, 2012, http://taxfoundation.org/article/testimony-proper-role-congress-state-taxation.