



## Legislative Fiscal Bureau

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May 4, 2017

TO: Representative Dale Kooyenga  
Room 324 East, State Capitol

FROM: Bob Lang, Director

SUBJECT: Tax Reform Proposal

At your request, I am providing information regarding a number of proposed changes to state and local taxes.

### INDIVIDUAL INCOME TAX CHANGES

#### Tax Rates and Brackets

Under current law, the state individual income tax is imposed using a marginal rate structure with four tax rates ranging from 4.0% to 7.65%. Under the proposal, the tax rates would be decreased in tax year 2018 as shown in Table 1.

TABLE 1

#### Current and Proposed Income Tax Rates and Brackets Tax Year 2018

<u>Single</u>	<u>Taxable Income Brackets</u>		<u>Marginal Tax Rates</u>	
	<u>Married-Joint</u>	<u>Married-Separate</u>	<u>Current</u>	<u>Proposed</u>
Less than 11,520	Less than 15,370	Less than 7,680	4.00%	3.95%
11,520 to 23,050	15,370 to 30,730	7,680 to 15,370	5.84	5.35
23,050 to 253,760	30,730 to 338,350	15,370 to 169,180	6.27	6.25
253,760 or more	338,350 or more	169,180 or more	7.65	7.45

Additional rate cuts would occur in tax years 2019 through 2029, when a flat 3.95% rate would be implemented. The additional rate reductions are shown in Table 2. As under current law,

the tax brackets would be adjusted each year based on changes in the consumer price index. It is assumed that the Department of Revenue (DOR) would adjust the withholding tables each January to reflect the lower tax rates.

**TABLE 2**

**Proposed Income Tax Rates  
Tax Years 2018 and Later Years**

	<u>First Bracket</u>	<u>Second Bracket</u>	<u>Third Bracket</u>	<u>Fourth Bracket</u>
Current	3.95%	5.84%	6.27%	7.65%
2018	3.95	5.35	6.25	7.45
2019	3.95	3.95	5.97	7.02
2020	3.95	3.95	5.77	6.71
2021	3.95	3.95	5.57	6.41
2022	3.95	3.95	5.36	6.10
2023	3.95	3.95	5.16	5.79
2024	3.95	3.95	4.96	5.49
2025	3.95	3.95	4.76	5.18
2026	3.95	3.95	4.56	4.87
2027	3.95	3.95	4.35	4.56
2028	3.95	3.95	4.15	4.26
2029	3.95	3.95	3.95	3.95

Under the schedule shown above, there would continue to be four tax rates and brackets in tax years 2017 and 2018, three rates and brackets in tax years 2019 through 2028, and one flat tax rate beginning in tax year 2029.

**Manufacturing and Agriculture Credit**

Under current law, the manufacturing and agriculture credit is equal to 7.5% of certain manufacturing and farm income derived from property located in Wisconsin. Under the proposal, beginning in tax year 2018, the credit rate for persons who claim the credit under the individual income tax would be set equal to the top individual income tax rates shown above. The 7.5% credit rate would be retained for corporate claimants.

**Alternative Minimum Tax**

The proposal would repeal the 6.5% alternative minimum tax, effective in tax year 2018.

**Working Families Credit**

Under current law, the working families credit eliminates or decreases state income tax liability for taxpayers with Wisconsin adjusted gross income (AGI) below \$10,000 (\$19,000 if

married filing jointly). The proposal would repeal this credit beginning in tax year 2018.

### **Capital Gains Exclusion**

Under the proposal, the current general exclusion for capital gains income (60% of gains on the sale of farm assets and 30% of other types of capital gains) would be repealed beginning in tax year 2018.

### **Property Tax/Rent Credit**

Under current law, the state provides an income tax credit equal to 12% of property taxes paid on a principal residence or rent constituting property taxes on a principal residence. Rent constituting property taxes is 20% of rent if heat is included in the rent payment or 25% of rent if heat is not included. The maximum credit is \$300. The proposal would repeal the credit for renters, effective in tax year 2019.

### **Itemized Deduction Credit**

Currently, taxpayers may claim a tax credit equal to 5% of the excess of certain federal itemized deductions over the state sliding scale standard deduction. The allowable deductions include mortgage interest paid on a primary residence or second home located in Wisconsin, charitable contributions, medical and dental expenses in excess of 10% of AGI (7.5% if age 65 or older), certain casualty and theft losses, and certain other interest expenses. The proposal would decrease the credit percentage from 5% to 3% in tax year 2019 and to 2% in tax year 2020 and thereafter.

### **Married Couple Credit**

Current law provides an income tax credit to two-earner married couples equal to 3% of the secondary earner's earned income, but not more than \$480. The proposal would repeal this credit beginning in tax year 2019.

### **Credit For Taxes Paid to Other States**

Under the proposal, the credit for income taxes paid to another state would be converted to a deduction for the income subject to taxation in the other state, except for the four surrounding states. This would take effect in tax year 2018.

### **Contributions from Individual Retirement Accounts to Charitable Organization**

The proposal would adopt federal law as it relates to contributions to charitable organizations from individual retirement account (IRA) distributions. For federal income tax purposes, individuals aged 70 ½ years of age or older may exclude from taxable income up to \$100,000 distributed from an IRA directly to a charitable organization. Wisconsin has not adopted that federal provision, so those contributions must be included in income and subject to state tax,

although the contributions may be used to calculate the state itemized deduction credit. This component of the proposal would adopt the federal treatment for state tax purposes beginning in tax year 2018. This would reduce state tax collections by an estimated \$4.8 million in 2018-19 and thereafter. Except for the effective date, this component is identical to AB 176 and SB 121.

## **CHANGES TO BUDGET PROVISIONS**

Under the proposal, the following provisions would be eliminated from the budget bill introduced by the Governor: (a) income tax rate cuts; (b) increased investment limit for qualified new business ventures under the angel and early stage seed tax credits; and (c) the young adult employment assistance tax credit.

Under the Governor's budget bill, beginning in calendar year 2018, the amount of federal historic rehabilitation tax credits that could be certified by the Wisconsin Economic Development Corporation would be limited to \$10 million per year. Under the proposal, the annual cap on credit certifications would first apply in tax year 2019 and would be set at \$35 million.

In addition, the proposed sales tax holiday would be held only in 2018, instead of in both 2017 and 2018. Also, the provisions regarding sales tax refunds related to private label credit cards would be repealed instead of delayed until September 1, 2019.

## **OTHER PROVISIONS**

### **First Dollar Credit**

The first dollar credit is a property tax credit extended to each taxable parcel of land on which improvements are located. For eligible properties, the credit is calculated by multiplying the property's gross school tax rate by a credit base value determined by DOR or the property's fair market value, whichever is less. For the 2016(17) property tax year, the base value was set at \$6,700, and the average credit is estimated at \$67. The credit's funding is provided by a \$150 million annual GPR appropriation. The proposal would phase out the credit by \$50 million per year in 2020-21, 2021-22, and 2022-23. Compared to current law, this would have the effect of increasing tax bills by \$22 in 2019(20), \$45 in 2020(21), and \$67 in 2021(22), and in each year thereafter.

### **School Levy Tax Credit**

The proposal would reduce the increase in the school levy tax credit proposed in AB 64/SB 30 by \$40.0 million in 2018-19. The bill would increase the distribution amount by \$87.0 million, from \$853.0 million to \$940.0 million beginning in 2018-19. This component of the proposal would reduce the increase to \$47.0 million and the funding total to \$900.0 million. The funding change would affect property tax bills beginning with 2017(18). Under the Legislative Fiscal Bureau's property tax bill estimates, the tax bill on a median-valued home taxed at the statewide average tax rate would be \$12 higher under the proposal than under AB 64/SB 30.

## **Annual Transfer of General Fund Revenues to the Transportation Fund**

A separate transportation budget proposal would end the annual transfer of 0.25% of general fund tax collections to the transportation fund in 2017-18 and thereafter. The savings of approximately \$40 million per year would be used to help fund the reduced income tax rates.

## **County Sales Tax on Motor Fuel**

The transportation proposal would also eliminate the current sales tax exemption for motor fuel, effective October 1, 2017. From the amounts generated from the county sales and use tax base expansion, the proposal would require the state to retain a \$18.0 million in 2017-18 and \$25.0 million in 2018-19 and thereafter to help fund the income tax rate reductions.

## **Taxation of Little Cigars**

Under current law, all cigars are subject to the tobacco products excise tax at the rate of 71% of the manufacturer's list price, but not more than 50 cents per cigar. Under the proposal, little cigars would be defined as any roll for smoking made wholly or in part of tobacco if such product uses an integrated cellulose acetate or other similar filter and is wrapped in any substance containing tobacco, other than natural leaf tobacco. Little cigars weighing less than three pounds per thousand would be taxed at a rate of 126 mills each, or \$2.52 per pack of 20 little cigars (the same rate imposed on cigarettes), effective October 1, 2017. It is estimated that excise tax revenues would increase by \$338,000 in 2017-18 and by \$450,000 in 2018-19.

## **FISCAL EFFECT**

The attachment to this memorandum shows the estimated general fund fiscal effects of the tax proposal compared to the budget bill introduced by the Governor. All of the out-year amounts in the attachment are expressed in 2018-19 dollars. Compared to the Governor's budget, it is estimated that the proposal would increase the balance of the general fund by \$89.4 million in 2017-18 and decrease it by \$74.0 million in 2018-19, for a net biennial increase of \$15.4 million.

The net fiscal impact of the tax proposal would increase significantly in later years as the additional income tax rate decreases are implemented.

I hope this information responds to your request. Please contact me if you have additional questions.

RR/sas  
Attachment



**ATTACHMENT**

**Estimated Fiscal Effect of Tax Reform Proposal  
General Fund Change to Governor's Budget Bill  
(Millions of 2018-19 Dollars)**

	<u>2017-18</u>	<u>2018-19</u>	<u>2019-20</u>	<u>2020-21</u>	<u>2021-22</u>	<u>2022-23</u>	<u>2023-24</u>	<u>2024-25</u>	<u>2025-26</u>	<u>2026-27</u>	<u>2027-28</u>	<u>2028-29</u>	<u>2029-30</u>
Proposed Individual Income Tax Changes	-\$85.1	-\$268.0	-\$200.3	-\$505.8	-\$779.4	-\$1,040.2	-\$1,294.9	-\$1,549.7	-\$1,803.9	-\$2,060.8	-\$2,316.9	-\$2,566.9	-\$2,704.8
Add AB 176 IRA Provisions	0.0	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8	-4.8
Delete Governor's Income Tax Rate Decrease	104.4	99.1	99.1	99.1	99.1	99.1	99.1	99.1	99.1	99.1	99.1	99.1	99.1
Sales Tax Holiday Only in 2018	11.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Delete QNBV Investment Limit Increase	3.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Delete Young Adult Assistance Credit	0.0	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Increase Cap on Historic Rehabilitation Credit	-2.4	-10.1	-15.5	-18.0	-20.6	-23.1	-25.0	-25.0	-25.0	-25.0	-25.0	-25.0	-25.0
Repeal Private Label Credit Card Law	0.0	0.0	8.7	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4	10.4
Phase Out First Dollar Credit	0.0	0.0	0.0	50.0	100.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0	150.0
Reduce School Levy Credit	0.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0	40.0
Eliminate Transfer to Transportation Fund	39.9	41.4	41.4	41.4	41.4	41.4	41.4	41.4	41.4	41.4	41.4	41.4	41.4
Retain County Sales Tax on Motor Fuel	18.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Modify Tax on Little Cigars	0.3	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
<b>Total</b>	<b>\$89.4</b>	<b>-\$74.0</b>	<b>-\$3.1</b>	<b>-\$259.3</b>	<b>-\$485.5</b>	<b>-\$698.9</b>	<b>-\$955.5</b>	<b>-\$1,210.3</b>	<b>-\$1,464.5</b>	<b>-\$1,721.4</b>	<b>-\$1,977.5</b>	<b>-\$2,227.5</b>	<b>-\$2,365.4</b>
<b>Out-Year Incremental Cost</b>			<b>\$71.0</b>	<b>-\$256.3</b>	<b>-\$226.2</b>	<b>-\$213.4</b>	<b>-\$256.6</b>	<b>-\$254.8</b>	<b>-\$254.2</b>	<b>-\$256.9</b>	<b>-\$256.1</b>	<b>-\$250.0</b>	<b>-\$137.9</b>

