INSTITUTE FOR REFORMING GOVERNMENT

Eliminate the Income Tax: Mythbusting

There have been numerous myths and distorted facts presented by opponents of meaningful tax reform. This document walks through a handful of the false claims made against this reform and presents the real facts.

MYTH #1: Eliminating the income tax while simultaneously increasing the sales tax by 3% is a regressive tax shift that hurts working families.

- **FACT**: The reform proposal lets all earners that pay state income taxes keep more of their money. All workers that pay taxes will see more money in their pockets when the state income tax is no longer collected. In addition to the immediate tax cut, eliminating the income tax will also prompt wage growth and encourage employers to hire more people, helping workers.

- **FACT**: Wisconsin already has strong progressive features built into its sales tax by exempting many of the everyday items that families routinely spend money on, and that doesn't change under this plan. According to Williams, about half of all consumption is exempt from the state sales tax.

- **The following is a small list of everyday items that the sales tax does not touch:**

  Groceries, rent, prescription drugs, childcare services, medical equipment, medical services, dental services, insurance, gasoline, home heating fuel like fuel oil and propane, residential electricity and natural gas in the winter months, barber and beauty shop services, self-laundry services, and many others.

- **FACT**: The income tax savings far outpaces the sales tax increase, making the proposal a substantial net tax cut. A household earning $61,105 will see a savings of $2,796 when the income tax is eliminated, according to Williams. Considering the 3% sales tax increase, that household would need to spend over $93,000 on taxable goods in order to negate a tax cut of this magnitude. The average net cut is projected to be $1,700.

- **FACT**: According to Professor Williams, **Middle class income filers pay the highest effective tax rate today, meaning they pay a higher percentage of wages in taxes than higher earners.** According to Professor Williams, households making between $36,551 and $126,449 actually pay higher real-world income tax rates than what is called for in law, with a family of four earning $50,000 paying nearly 10% to state income taxes. That's because of the technical aspects of state tax credits and the state standard deduction, and how they impact the amount owed as the credits are phased out with higher earnings.

- **FACT**: Eliminating the income tax does not automatically mean the end of refundable tax credits that low-income families rely on like the Homestead Tax Credit, the EITC, and others. Policymakers could decide to continue having these refundable tax credits for low income families, and could also consider a sales tax rebate for low income families or the elderly, as some no-income tax states provide, to offset any increase they may face from the sales tax modification.

MYTH #2: Retirees will be hit hard by the tax reform

- **FACT**: Wisconsin retirees know all too well that retirement does not mean you no longer pay income taxes. While Wisconsin does not tax social security income, it does tax private pension income and income from some retirement accounts. Eliminating the income tax would end that taxation in retirement and let seniors keep their well-earned retirement income.

- **FACT**: Many items that seniors spend much of their fixed incomes on are already exempt from the sales tax, including essential items like:
  Groceries, rent, insurance, prescription drugs, medical equipment, doctor and dental visits, gasoline, home heating fuel like fuel oil and propane, and residential electricity and natural gas in the winter months.

- **FACT**: Retirees have been voting with their feet for years, and they continue to leave Wisconsin for states like Florida and Texas, where there is no income tax - even though the sales tax there in those states is higher than Wisconsin's currently. When they leave, they take their experience, capital, and savings with them. While we can't change the weather, we can make our tax climate competitive to encourage them to stay home.

MYTH #3: The higher sales tax will discourage consumer spending.

- **FACT**: Households will have, on average, an additional $2,800 back in their paychecks to spend or save. Even with a higher sales tax considered, consumers will have greater purchasing power of $1,700 per household to spend at stores and restaurants.

MYTH #4: The plan leaves an unsolvable $3 billion budget deficit.

- **FACT**: State revenues have been inflated in recent years due to federal COVID-19 relief spending. That bloated revenue should not be expected to be the starting point for state budgets going forward. As noted in the CROWE report, this reform returns state tax revenue in 2023 to what it was in 2020, before the huge and unexpected increase in 2021. After that, tax revenues continue to rise in the CROWE projections.

- **FACT**: The reform is about right-sizing state revenue and giving the economy a shot in the arm. According to the Kaiser Family Foundation, Wisconsin is the **12th highest per capita spending state at $8,629 per year.** The nine states without an income tax, spend on average, **$6,427 per capita**. Every no-income tax state but one, Alaska, spends less per capita than Wisconsin.

- ➔ The state currently has a $2.58 billion cash surplus, which means the state has been taking too much from taxpayers in recent years. This reform corrects this, and, with prudent management by lawmakers going forward, as they have done for the last decade, coupled with dynamic growth caused by eliminating the income tax, the stage is set for a balanced budget during the 2023 budget debate and beyond in Madison.