IRG Playbook for Income Tax Relief in Divided Government

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Institute for Reforming Government

Historic Tax Relief for the Middle Class and Small Businesses

The Institute for Reforming Government (IRG) has developed new proposals that would provide historic tax relief for middle class families and small businesses, even in divided government. <u>Those proposals are included in this playbook, and provide a pathway for Governor Evers and lawmakers to come together,</u> depending on how bold they dare be, in a showing of bipartisanship to build on the $3.4 billion ($2 billion income) tax relief they supported in 2021.

While complete income tax elimination remains the single best reform that could be enacted this year to drive economic growth, policymakers can still move the ball forward and help all Wisconsinites by adopting one of the new plays provided here.

Playbook for income tax reform.

IRG developed several new income tax relief options, and asked the team at the Center for Research on the Wisconsin Economy (CROWE) at the University of Wisconsin-Madison to analyze them to determine the impacts each would have on families and the economy. This playbook outlines the plays and the related economic analysis.

Generally speaking, CROWE's dynamic analysis of these plays finds that each, while varying in their magnitude, would have a positive impact on low and middle income Wisconsinites. Compared to the status quo, each would enlarge paychecks, increase capital, drive economic growth, and most importantly would provide historic tax relief for low and middle income earners and small businesses at a time when it's needed most.

This playbook also looks at Senator LeMahieu's 3.25% flat tax proposal, the tax plan put forward by Governor Evers in his 2023 Executive Budget proposal, and the plan IRG put forward in December 2021 to completely eliminate the personal income tax in Wisconsin.

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New Play 1. Reduce all brackets by 1.5 points. This plan maintains the current number of income tax brackets at four, but reduces each by 1.5 points. That means the largest bracket cut, a 42.3% reduction, would occur for low income earners, while high earners will see a smaller 22.5% bracket reduction.

Highlights of play 1

- **$716 annual tax cut** for a median family, a 30.05% reduction
- Significant tax relief for all - **$2.75 billion**
- 2.86% increase in after tax income for medium families
- 2.42% capital investment growth
- 0.22% overall wage growth
- 1.8% labor growth
- 2.08% economic output growth
- 1.51% corporate tax growth
- 2.26% sales tax growth

New Play 2. Eliminate one bracket, reduce remaining to 2%, 4.5%, and 6.15%. Play 2 flattens taxes slightly by eliminating one tax bracket, but largely maintains the progressive tax system that Governor Evers wants to preserve. Play 2 provides the largest cut of the new options for those at the lowest bracket. Lowering the top bracket provides a mechanism for strong economic growth.

Highlights of play 2

- **$669 annual tax** cut for a median family, a 28.07% reduction
- Significant tax relief for all - **$2.66 billion**
- 2.15% increase in after tax income for medium families
- 1.67% capital investment growth
- 0.22% overall wage growth
- 1.1% labor growth
- 1.33% economic output growth
- 0.77% corporate tax growth
- 1.71% sales tax growth

New Play 3. Eliminate two brackets, set remaining brackets at 2% and 4.5%. Similar to a recent plan put forward by Representatives Jerry O'Connor and John Macco, Assembly Bill 262, this option would significantly flatten income taxes, from 4 brackets to 2, dropping the tax liability for all workers.

Highlights of play 3

- **$635 annual tax cut** for a median family, a 26.64% reduction
- Significant tax relief for all - **$2.91 billion**
- 2.93% increase in after tax income for medium families
- 2.85% capital investment growth
- 0.47% overall wage growth
- 1.67% labor growth
- 2.14% economic output growth
- 0.96 corporate tax growth
- 2.44% sales tax growth

Other plays under consideration.

Along with these new plays, there are other plans under consideration. For this comparison, IRG asked CROWE to analyze Senator LeMahieu's flat tax play, and Governor Evers' budget proposal. Also included are the highlights from the CROWE analysis of IRG's 2021 proposal to eliminate the income tax while raising the sales tax by 3 points.

3.25% flat tax. Senate Majority Leader Devin LeMahieu introduced a 3.25% flat tax as 2023 Senate Bill 1. Like all of these highlights, CROWE's analysis is dynamic - meaning it considers the future impact of tax cuts when determining the economic impact, setting the analysis ahead of the static review provided by the Legislative Fiscal Bureau.

Highlights of Senate Bill 1, 3.25% flat tax:

- **$661 annual tax cut** for a median family, a 27.73% reduction
- Significant tax relief for all - **$3.13 billion**
- 5.08% increase in after tax income for medium families
- 5.49% capital investment growth
- 0.65% overall wage growth
- 3.8% labor growth
- 4.47% economic output growth
- 2.79% corporate tax growth
- 4.29% sales tax growth

Governor Evers' 10% tax cut. Governor Evers' proposed 2023-2025 budget included tax credits that amount to a 10% tax cut for low and middle income earners. To measure the impact of such a cut, the team at CROWE reduced the lower three brackets by 10%, leaving the top bracket at the current 7.65%. Because it does not lower the top rate, the economic impact is much lower than the other proposals. It should also be noted that his budget proposal also included significant tax increases on manufacturers. Those tax increases are not part of this analysis, and would reduce the overall economic growth prospects of the proposal even further.

Highlights of Gov. Evers' 10% income tax cut:

- **$225 annual tax cut** for a median family, a 9.43% reduction
- Minimal tax relief for all - **$0.76 billion**
- 0.61% increase in after tax income for medium families
- 0.38% capital investment growth
- 0.0% overall wage growth
- 0.38% labor growth
- 0.38% economic output growth
- 0.38% corporate tax growth
- 0.43% sales tax growth

Eliminate the income tax. In December 2021, IRG released a proposal to completely eliminate the personal income tax in Wisconsin, offsetting some of the revenue loss with a 3 point increase in the state sales tax rate, from 5% to 8%. CROWE analyzed the proposal at the time, finding it would be a gamechanger for Wisconsin's economy.

Highlights of IRG's plan to eliminate the income tax:

- **$1,700 annual tax cut** per household
- Significant tax relief for all - **$3.5 billion**
- 9.4% increase in after tax income
- 6.9% labor growth, 175,000 jobs
- 7.9% economic output growth, $28 billion
- 7.2% sales tax growth

Time to pick a play.

Lawmakers are currently debating the 2023-2025 state budget, with the new fiscal year starting on July 1. There is a great opportunity for policymakers to do what they did in 2021 and enact significant bipartisan income tax relief. With a looming recession, high inflation, and a $6.9 billion state surplus, the opportunity for bold bipartisan action has never been greater.

All across the country, from Republican-led Iowa to Democratic-led Colorado, states are working to cut income taxes and move ahead of Wisconsin. In 2021, eleven states reduced their income taxes and ten more made cuts in 2022. Just five years ago Kentucky was only the fourth state in the nation to go to a flat tax. Last year alone, four new states started the march toward a flat tax. If we are not taking bold action to reduce income tax we are falling behind.

Governor Evers and Wisconsin lawmakers have a chance to put Wisconsinites ahead of special interests by taking strong action in 2023 on income tax reform. The plays outlined in this playbook give them options for success. They can be extremely bold and eliminate the income tax as IRG proposed in 2021, or they can pick one of the other plays outlined above.

Why are new plays on income tax relief needed now?

While the debate on tax reform has stagnated in Madison, families and small businesses continue to need help and demand action. Other states are taking action, and Wisconsin can't afford not to do the same.

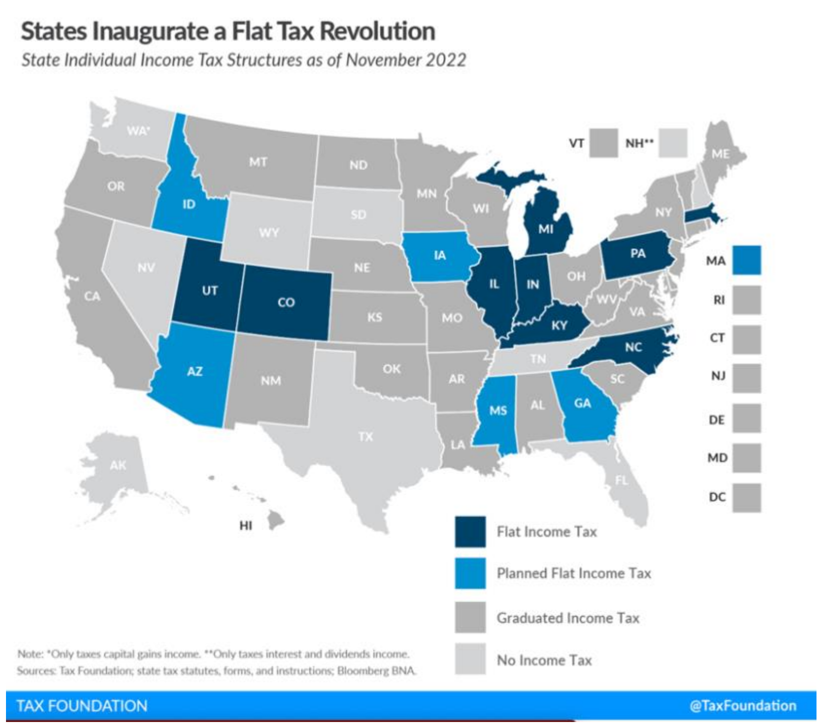
Inflation and recession fears mount. For almost two years, Wisconsin families have been struggling with historic inflation, and now, many economists agree that we are headed into a recession. Inflation is still almost 5% as of April 2023. Workers and middle class families need policymakers to let them keep more of what they earn, rather than pumping more money into government spending. Families need help now, not government.

Workers following tax trends. The Tax Foundation has found that Americans are moving to states with low taxes. The evidence is real. People are moving, and are voting with their feet that they prefer low-income tax states.

Wisconsin needs to compete. Other states are pushing bold tax reform, giving themselves a competitive advantage. Our neighbors in Iowa are working to eliminate their income tax, as are states like Arkansas and Missouri. Even the Democratic Governor of Colorado believes his state should eliminate their income tax.

Demographics demand action. Beyond migration patterns, Wisconsin birth rates continue to fall, now well below the national average. Connected, the population continues to age - with many counties projected to have 30+ percent of their population over age 60 by 2040.

Couple those demographic trends with historic low workforce participation rates (64.6% in March 2023), and it's clear that Wisconsin cannot afford to sit out the national battle to attract workers. Income tax cuts will increase wages and take home pay, encouraging people to reenter the workforce. If large enough, tax relief will also encourage workers to move here from other states. Wisconsin is either going to fight for those moving to low tax states or be left behind.



Small businesses face high taxes. A vast majority of small businesses file taxes as individuals. Combined with federal taxes, they pay almost 48% of their income to government. By cutting income taxes, policymakers are helping mainstreet employers that keep our communities moving forward.

Voters support income tax relief. In recent statewide polling by Morning Consult, 70% of Wisconsinites said they believe that lowering the income tax would help alleviate the worker shortage and 75% said they supported lowering income tax. In December of 2022, 59% of Wisconsinites thought that the state's income taxes were too high. In the crosstabs of the recent Morning Consult statewide polling, even 72% of democrats said they support lowering the income tax as a means to address the state's labor shortage.

Historic surplus provides opportunity. Wisconsin has a historic $6.9 billion surplus. This is money that taxpayers have paid, through income, sales, and other taxes. It's money that has not been in family savings accounts, spent on groceries, or donated to charity. Instead it's sitting in the government's checkbook, not adding to the economy or helping families. Meanwhile special interest groups are lining up to spend this money on pet projects. Instead, policymakers have an opportunity to return the surplus through tax relief, while fixing the state's tax collections so it stops taking more money than is budgeted to be spent.