

## 'Tis the (other) season: Wisconsin income tax has surprises

*Wisconsin's individual income tax is the nation's oldest. Last year, it generated \$7 billion, far more than other state taxes. A little more than 30 states have "progressive" income taxes. Wisconsin's is unusual due to the rapidity with which its tax rates rise and a standard deduction that disappears as income increases. The result is higher ranking taxes on middle-income filers.*

For many, 'tis not the season to be jolly. The holidays are gone, and income tax season runs through April 18. This does not mean many taxpayers prepare their forms. A large majority uses tax professionals or software for help. As a result, public understanding of the state's individual income tax is limited.

### Preliminaries

■ **History.** Enacted in 1911, Wisconsin's income tax is the nation's oldest, predating the U.S. tax. From the start, it was a "progressive" tax; i.e., it claimed a larger share of income as income rose.

Originally meant to raise money to share with localities to reduce property taxes, it had, by the 1920s, already become a major source of funding for an expanding number of state programs.

■ **Scope.** Today, it is state government's largest tax, responsible for underwriting over half of general fund expenditures, principally education, health, prisons, and property tax relief.

During last year's tax season, filers submitted 3.03 million (m) returns and reported \$163.1 billion (b) in adjusted gross income (AGI). Of all filers, 2.14m (about 70%) paid taxes. With net revenue of \$7.10b, the average tax rate paid relative to AGI was 4.35%.

■ **National context.** Even today, more than 100 years after Wisconsin invented it, seven states do not tax income and two more tax only dividends and interest. Another eight have just one tax rate (a so-called "flat tax").

### Wisconsin unusual?

That leaves a little over 30 states with progressive income taxes. Wisconsin's tends to be at the more progressive end of the spectrum. But how the Badger State accomplishes this is unusual.

■ **Tax rates compared.** Most often, a system of rising rates and brackets makes a state income tax progressive. Wisconsin has four tax rates ranging from 4.00% on the first "slice" (bracket) of income to 7.65% on the last. At the lowest rate, 4.0% is higher than all but eight states. The highest rate (7.65%) exceeds that of all but nine states.

All four rates and brackets are shown (right) for married couples who filed jointly in 2015. The same rates apply to other filers, e.g., singles, though the income groupings differ. It is the "rapidity" with which the rates rise to 5.84% and 6.27% that has some surprising effects.

■ **Standard deduction.** In addition to one or more rates, income taxes usually have a standard deduction. At the federal level and in most states, it is a flat dollar amount used by taxpayers who do not itemize deductions for property taxes, contributions, and the like.

Wisconsin's standard deduction applies to all taxpayers and, most significantly, declines as income rises. Thus, the full amount for a married couple filing jointly last year was \$18,460. Above \$20,740 of AGI, however, it begins

to drop, reaching \$0 above \$114,075. These amounts have since increased.

This feature is rare among states: Tax burden rises over the middle-income range, not just because of increasing tax rates, but also because taxes increase as the standard deduction is lost.

■ **Itemized deductions.** How itemized deductions are limited can also affect taxes owed. Unlike other states, Wisconsin allows itemizing only to the extent the deduction total exceeds the standard deduction. And the tax benefit of that excess is allowed only as a 5% tax credit.

■ **Other tax credits.** Other state tax credits are also limited by either applying only to low-income filers (e.g., earned income and homestead) or capping the maximum that can be claimed (e.g., married couple, \$480; and property tax-rent, \$300). Such features further impact taxpayers as income rises.

### Pulling it together

By now it is apparent that Wisconsin's income tax is complex and attempts in multiple ways to reduce taxes on low incomes and raise them on high incomes. What is not evident is that some of these features have unintended consequences.

One of the simplest ways to see this comes from a Minnesota study that calculated 2013 income tax burdens at various income levels for typical filers in every state (back). Wisconsin law has changed somewhat since then, but the findings still apply.

The table lists income levels for married joint-filers from \$20,000 to

\$1m. For each, it compares the average state income tax burden (U.S.) with the amount owed in Wisconsin. It then ranks that burden across all income-tax states and compares it to the average state burden. Three patterns emerge.

■ **Lower.** First, at lower income levels, due to the standard deduction and low-income tax credits, a married couple at \$20,000 receives a check (-\$591). That places Wisconsin's burden at 32nd, 51.2% below average and one of the lowest among income-tax states. Similar results are found at \$35,000.

■ **Middle.** Between \$50,000 and \$150,000, taxes rise quickly. At

#### State Income Taxes, Ranks by Income

Estimates from MN Center for Fiscal Excellence

Income (\$000)	Tax Amt. (\$)		Wis. Rank	WI-US % Diff.
	U.S.	Wis.		
20	-391	-591	32	-51.2
35	353	125	25	-64.6
50	1,358	1,383	19	1.8
75	2,415	2,811	13	16.4
100	3,693	4,297	10	16.4
150	6,217	7,069	13	13.7
250	11,561	12,457	18	7.8
500	25,719	28,164	17	9.5
1,000	55,837	64,441	13	15.4

\$100,000—appropriate for two spouses each earning \$50,000—the tax bill is \$4,297, 10th highest and 16.4% above average.

■ **And up.** At higher levels, the top rate eventually applies. Taxes continue to rise, e.g. \$28,164 at \$500,000. Burdens are from 7.8% to 15.4% above average, with rankings in the 13th to 18th range.

#### Malcolm in the middle

Why do income taxes here rank unusually high on middle-income filers? Other than accident and piecemeal lawmaking, one reason is that Wisconsin has always had a progressive income tax; it relies heavily on it. With only 10% to 15% of income both under \$40,000 and above \$500,000, the state turns to those between \$40,000 and \$150,000—where over half of income to tax is found. □



#### Wisconsin Taxpayers Alliance

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## Capital Notes

■ Last year, Wisconsin taxpayers filed for the 2015 income tax year. As the table (right) shows, the total number of returns was 3.0 million. Adjusted gross income (AGI) totalled \$163.1 billion and generated \$7.1 billion in state individual income taxes.

A majority of the returns (58.6%) reported income under \$40,000. These filers accounted for 16.3% of income and paid 7.2% of taxes. A majority of the income (51.3%) was reported by filers in the \$40,000 to \$150,000 range, and they paid 51.3% of the taxes (Source: Wis. DOR)

Reflecting the progressive nature of the tax, those with incomes above \$100,000 paid 60.4% of the taxes on 49.4% of AGI.

Adj. Gross Inc. (\$000)	No. Returns		Adj. Gross Inc.		Net Tax	
	(000)	% Tot.	\$ bill.	% Tot.	\$ mill.	% Tot.
Under 10	720.7	23.8	1.24	0.8	12.4	0.2
10 - 20	393.4	13.0	5.85	3.6	44.5	0.6
20 - 40	660.9	21.8	19.49	11.9	456.1	6.4
40 - 60	414.0	13.6	20.35	12.5	740.2	10.4
60 - 80	271.4	8.9	18.84	11.5	788.6	11.1
80 - 100	188.0	6.2	16.80	10.3	766.2	10.8
100 - 150	230.8	7.6	27.71	17.0	1,350.2	19.0
150 - 200	71.8	2.4	12.25	7.5	628.1	8.9
200 - 500	65.7	2.2	18.77	11.5	1,044.8	14.7
Over 500	16.7	0.6	21.84	13.4	1,265.3	17.8
Totals	3,033.5	100.0	163.14	100.0	7,096.3	100.0