Has Wisconsin’s State Tax System Become Less Fair?

Changes in the Distribution of Tax Burdens from 1974 to 1995

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and
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EXECUTIVE SUMMARY

Wisconsin was the first state to establish an individual income tax. From its beginning in 1911, the tax was progressive—people with lower incomes paid a smaller percentage of their income as taxes than persons with higher incomes. Over the past twenty years, Wisconsin policymakers have made substantial changes in the state tax system. These changes have been piecemeal, impacting different constituent groups at different times and in different ways. The authors of this study consider the cumulative impact of these changes and how they have altered the distribution of burdens of the state tax system. They do this by analyzing the changes in the distribution of income, sales and excise taxes across income groups between 1974 and 1995.

Using adjusted 1974 income and tax data from the Wisconsin Department of Revenue's Wisconsin Tax Burden Study (1979) and 1995 income and tax data from a study conducted by the Citizens for Tax Justice and the Institute on Taxation and Economic Policy (1996), Professor Andrew Reschovsky and Chad Reuter’s study reveals how major elements of our tax system changed over the past couple of decades, and how each change affected the relative tax burden on non-elderly, married couple families.

The key findings from this analysis are:

1) Wisconsin’s state tax system has become somewhat less progressive over time. In 1974 taxes were progressive over the bottom 95 percent of the income distribution. By 1995, the distribution of burdens was more or less proportional to income over the top 80 percent of the income distribution.

2) Many couples with very modest incomes face high state tax burdens—burdens that average more than five percent of their incomes.

3) Over the past 20 years, middle and lower-middle income families faced the largest increases in tax burdens.

4) Taking into account the ability of upper-income taxpayers to deduct their state income tax payments from their income subject to the federal income tax, the tax burden on the richest 1 percent of the state’s taxpayers is about equal to the tax burden on the poorest 20 percent of taxpayers.
Reviewing changes in Wisconsin State Tax Law between 1974 and 1995, Reschovsky and Reuter find that some tax policies have reduced tax burdens on families with modest incomes. These include:

- Changing itemized deductions to credits.
- Increasing the standard deduction.
- The use of the property tax and rent credit, the married couple credit and the earned income tax credit.

However, the effects of these progressive policies do not outweigh the regressive fiscal impact of other policy changes:

- Income tax rates rose for lower income families while dropping for households with higher income.
- Increases in the proportion of long-term capital gains excluded from taxation bestow the largest benefits on wealthy taxpayers.
- Sales tax rates increases had the largest impact on lower- and middle-income families.

Based on these findings, the authors note a number of ways that the state tax system could be made more progressive:

- Increase the graduation of the income tax schedule to raise rates for those at the upper end of the income scale.
- Tax capital gains at the same rate as other income.
- Increase the standard deduction.
- Include a number of currently exempt goods and services in the sales tax.

Given these changes, the progressivity of the state’s tax system would be increased and the burden currently placed on low- and middle-income taxpayers would be reduced. Because the scope of this study was limited to consideration of the income, sales, and excise taxes, the authors recommend that the state undertake a comprehensive study of the distribution of tax burdens, which would consider the effects of all state and local taxes, including the property tax. That way, policymakers could have more information on which to base changes in our tax system.