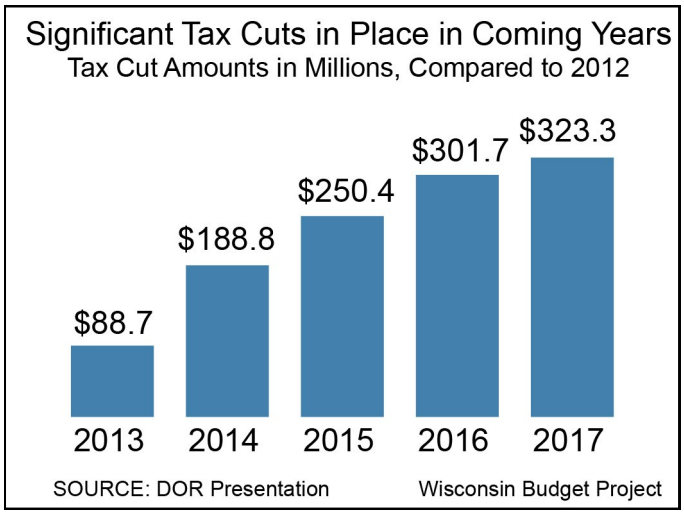
New Year Brings New Tax Cuts to Wisconsin

Previously Passed Cuts and Credits Will Reduce Revenue by $262 million in 2013-15

There are at least nine tax cuts or credits that are either new or expanded for tax years 2012 and 2013. The tax year 2012 changes will first appear on state tax forms filed this year. We have also included tax changes that begin or expand in 2013 because they may affect withholding or taxpayer behavior this year.

Many of the tax cuts are phased in over time, an approach that made the tax reductions seem affordable at the time they were passed, but will significantly reduce the resources available to invest in our schools, roads, and communities when the full cost of the tax cuts comes due.

The cost of each of these tax cuts, represented by revenue lost to the state over the next two-year budget period, ranges from more than $100 million to as little as $1 million. These tax changes yield an estimated $88.7 million cut in state taxes in the current fiscal year (FY 2013) and a total of $528 million during the three-year period of FY 2013 through FY 2015 (measured relative to FY 2012).



Some of these tax cuts were enacted years ago and are only now being fully implemented or expanded. The chart above shows the rising cost of all the previously enacted tax cuts, from FY 2012 through FY 2017, based on Department of Revenue estimates (using FY 2012 as the base level of revenue). However, unless noted otherwise, the other figures in this paper reflect just the growth in the tax cuts in the 2013-15 biennial budget, relative to FY 2013.

Additional tax cuts may be on the way. The Governor and legislative leaders have said they will make an income tax cut a top priority in the next legislative session. Some policymakers have said they would like the income tax to be "flatter," which could result in a new tax cut for top earners.

Nine New or Expanded Tax Cuts

New or expanded tax cuts in tax years 2012 or 2013 include:

- <u>A deduction for certain health insurance premiums, $114.3 million cost over the coming budget period, compared to fiscal year 2013 levels</u>

  Individual income tax deductions for the share of health insurance premiums paid by employees rise to 45% in 2012 and 100% in 2013 and thereafter. Income tax filers can deduct these expenses from their income regardless of whether they itemize or claim the standard deduction.

  This provision was originally enacted as part of the 2007-09 budget, but the scheduled phase-in was later postponed.

- <u>The start of a nearly total phase-out of income taxes for manufacturers and agricultural producers, $102.2 million over two years</u>

  This new credit is based on income derived from manufacturing or agricultural property, and can be claimed through the individual or corporate income tax. It phases in over four years -- starting at 1.9% of business income in 2013, and gradually increasing to 7.5% in 2016 and beyond.

  The corporate income tax rate in Wisconsin is 7.9%, so when the credit is fully phased in,

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businesses receiving the credit would be paying an effective income tax rate of 0.4% on income that qualifies for the credit. A business with $1 million in taxable income could see its taxes drop from $79,000 to $4,000.

When the credit is fully phased in, businesses will be paying an estimated $129 million less in income tax each year. The cumulative ten-year cost of the credit is $874.5 million.

The credit does not require businesses to create any jobs. In fact, even businesses that initiate massive worker layoffs could qualify for this tax break.

- A credit for electronic medical records, which costs an added $5.5 million in this fiscal year

  Health care providers can claim credits worth up to half the amount they spend on hardware or software used to maintain electronic medical records. This credit was first available for tax years starting in 2012. The legislation was originally enacted as part of the 2007-09 budget, but full implementation was later postponed. The annual cost grows to $10 million in the current fiscal year, compared to $4.5 million in FY 2012.

- A deduction for child care expenses, $9.2 million over two years

  In tax year 2012, individuals can deduct up to $3,000 in child and dependent care expenses, up from a maximum of $1,500 in 2011. For tax year 2013, the maximum deduction rises to $4,500. It was originally enacted as part of the 2007-09 budget, but the phase-in was later postponed.

- Loosening restrictions on investments that qualify for angel investment credits, $9.1 million over two years

  A law that went into effect in April 2012 made changes to the parameters for businesses that investors may invest in to get this income tax credit, and relaxed rules on how long investors must hold investments to qualify for the credit.

- A credit for expanding a dairy farm, $4.4 million over two years

  Corporations who expand or modernize a dairy farm are eligible to receive a credit for up to 10% of the cost of the activities. This credit was originally set to sunset at the end of 2011, but legislation was passed that extended the credit through the end of 2016.

- Allowing corporations located in multiple states to shift prior losses to the state with the most favorable tax treatment, $3.8 million over two years

  Multi-state corporations can shift businesses losses incurred before 2009 to other states. Starting with tax years beginning in 2012, a corporation can use up to 5% of its business loss to offset its total income, for the next 20 years.

- A tax credit for biodiesel production, $5.1 million in this fiscal year

  Businesses producing at least 2.5 million gallons of biodiesel fuel a year are eligible for a credit of $0.10 credit per gallon, for tax years beginning in 2012, 2013, or 2014.

- A tax credit for hiring disabled veterans who are receiving unemployment benefits, $1.3 million over two years

  Individuals and businesses who hire disabled veterans receiving unemployment benefits at the time of hire may receive a credit of up to $10,000 over four years. This credit was first available for tax years beginning in 2012.

Expanded Tax Cuts Can Lead to Painful Spending Cuts

The new year brings a collection of new tax cuts, and expansion of pre-existing cuts. Phased-in or delayed tax cuts are easier to enact than cuts that go into full effect immediately, because the revenue impact is not felt until later down the road. But when the full cost is realized, legislators must either reduce spending or find other sources of revenue.

Additional or expanded tax breaks are already scheduled for future years. Income taxes on manufacturers will plunge in coming years, meaning that an important sector of Wisconsin's economy will be all but exempt from paying income taxes.

Given the substantial price tag of the tax cuts that have been pushed down the road and will come due in the next few years, the state should proceed with caution in implementing new tax breaks.

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