

The **Road** to a **Flat** **Tax**



May 2017

WISCONSIN ASSEMBLY

GOP

Wisconsin has tackled many problems since 2011 when the Governor's Office, Senate and Assembly switched from Democrat to Republican control. Some of our accomplishments since 2011 are:

- Educational outcomes have improved.
- The state is more solvent:
 - The Rainy Day Fund is at an all-time high – it is 165 times larger than it was in 2011.
 - The GAAP deficit has decreased by 43%.
- Taxes are lower:
 - Our property tax burden, relative to personal income, is at the lowest point since WWII.
 - Income taxes are lower and less complex.
- Seven years ago we had more available workers than jobs; now we are experiencing a worker shortage:
 - Our unemployment rate has declined since 2011 and is currently at the lowest rate since 2000.
 - The highest number of people are working in Wisconsin's history.

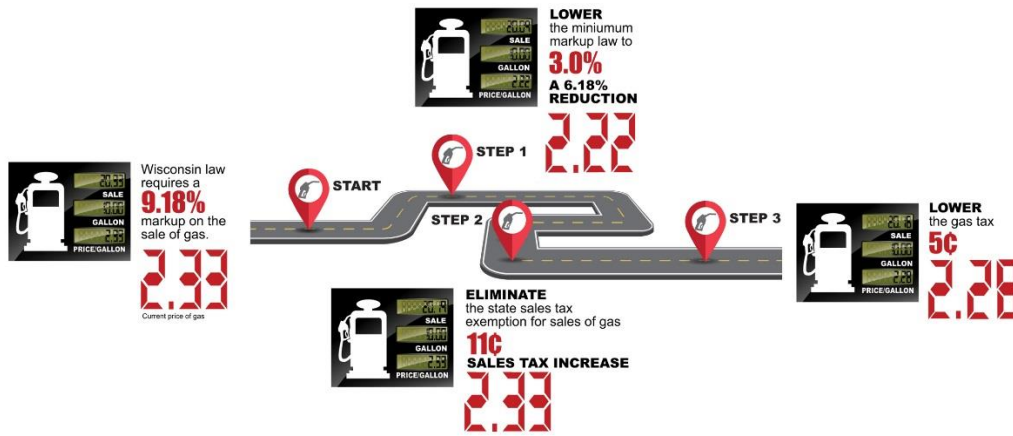
However, there are two areas in which Wisconsin is either falling behind or not making satisfactory progress:

1. The state's transportation system is degrading; meanwhile the percentage of revenue dedicated to debt service is at an unhealthy level and continues to grow.
2. The state's income taxes are among the highest in the country and are also among the most complicated. Our standard form is twice as long as the federal form and our income tax rates are among the highest in the nation.

Neither of these challenges can be solved in a single two-year budget cycle. However, we can start moving toward a more solvent transportation fund and a simpler tax code right now. The proposal that follows puts Wisconsin on a long-term trajectory to improve our infrastructure while significantly lowering our tax burden.

If the following proposal is adopted, Wisconsin's transportation fund solvency will improve, our roads will be in better condition and Wisconsin's income taxes will be lower, fairer and flatter.

TRANSPORTATION REFORMS



The current growth of transportation bonding is unsustainable. This proposal allocates 100% of new revenues raised to the reduction of bonding. Reducing the level of bonding in the transportation fund will realize additional money since tens of millions of dollars will be diverted from paying for interest costs to paying for actual infrastructure costs. Paying for \$300 million in projects with cash instead of bonding will save taxpayers \$150 million over the course of a typical financing period. Every portion of this proposal is consistent with conservative principles.

Start: Wisconsin's Unfair Sales Act – the Minimum Mark-Up Law

Since 1939, Wisconsin law has prohibited the sale of gasoline, tobacco & alcohol below a minimum marked-up amount based upon the cost of these products. To calculate the amount for these products, first take the invoiced price, add transportation costs (2 cents), and then add federal, state & local taxes. This amount is then marked-up 3% by wholesalers and then 6% by retailers. The overall effect is a 9.18% markup. The Unfair Sales Act also prohibits the sale of any other product below cost. Cost is not specifically defined for items outside gasoline, tobacco & alcohol. Currently only eleven states prohibit the sale of gasoline below cost. Only two states, Wisconsin and Minnesota, go on to specify a specific required mark-up.

Step 1: Lower Wisconsin's Minimum Mark-Up Law

Wisconsin's minimum markup law has resulted in Wisconsin consumers paying higher prices than what the free market would otherwise allow. In particular, state statute treats gas in a unique way and actually defines how much gasoline needs to be marked up. This proposal attempts to reach a middle ground by lowering a percentage of the minimum

mark-up law which in turn will place downward pressure on the pump price. Business owners have confirmed that a law change such as this one will lead to lower gas prices.

For example, Krist Atanasoff, owner of 33 gas stations in northeast Wisconsin, has stated that he wants to sell gasoline to customers at a markup closer to 3% but has been prevented from doing so by Wisconsin's minimum mark-up law. He also owns gas stations in Michigan; the smaller mark-up more closely aligns to his mark-up on gas in Michigan. Krist points out that although Michigan's gas taxes are higher, his gas is more expensive in Wisconsin due to the minimum mark-up law.

Step 2: Apply Wisconsin Sales Tax to Motor Fuels

Important elements of a good tax code are to have a broad base and limit exemptions. The Wisconsin sales tax does not apply to the sale of fuel. By eliminating the sales tax exemption on fuel, the transportation fund will realize \$300 million annually in additional revenue. The application of the sales tax also allows the transportation fund to move away from entirely stagnant revenue sources and protects the fund from inflationary pressures similar to the inflation protections naturally built into the general fund.

Step 3: Lower the Wisconsin Gas Tax

Following elimination of the sales tax exemption and a reduction in bonding, there will be sufficient revenue remaining to actually lower Wisconsin's gas tax by 5 cents per gallon.

Lower Proposed Bonding

The current budget proposes \$500 million in new bonding. The additional revenue created by this proposal would be sufficient to reduce the proposed bonding by \$300 million. The reduction in bonding changes the trajectory of the transportation fund that is dedicated to debt service downward. By 2018, the transportation fund will be paying \$413 million a year in debt service alone which represents 22% of the pre-reform transportation fund revenue. This proposal reverses the trend line for debt service, as a percentage of revenue, decreasing it for the first time in decades.

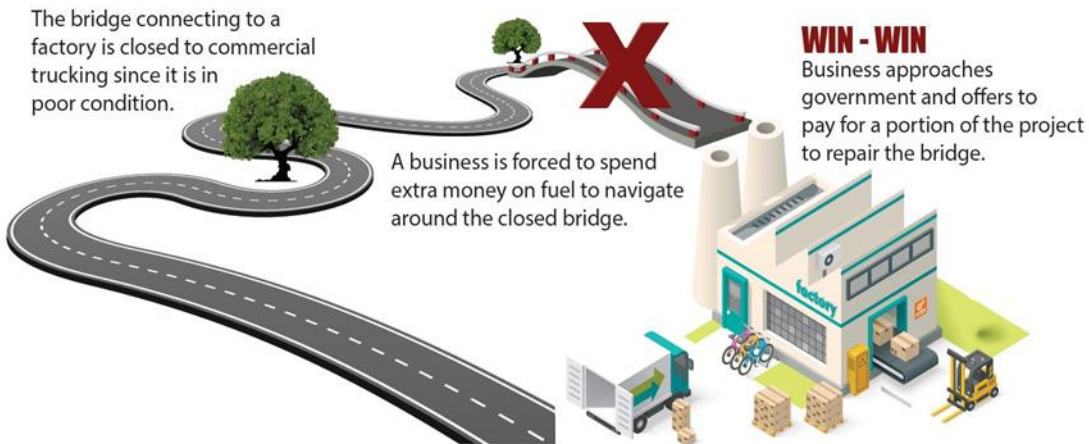


CUTTING COST AND IMPROVING EFFICIENCY

PUBLIC-PRIVATE PARTNERSHIPS

Wisconsin's economy depends on a functional transportation system. When there are significant deficiencies, there are economic costs – 14% of Wisconsin's bridges are in poor or failing condition. In order to help extend the life of these bridges, the weight limits

have been lowered. Casual observers may not readily recognize the poor state of certain bridges because most are sufficiently safe for average weight vehicles but they are not safe for heavier, commercial trucks. The situation forces large commercial trucks to navigate around these bridges.



Under this proposal, Public-Private Partnerships would require state and local units of government to grant special consideration to any infrastructure project in which 10% or more of the cost is covered by a private interest or a coalition of private interests. Government does a poor job of prioritizing projects; allowing private sector entities to assist with paying for a project will naturally send a signal to government that the private sector places a higher priority on some projects over others.

Here is an example of such a partnership.

A local paper plant has to reroute dozens of timber trucks every day in order to avoid a posted bridge that increases the number of miles driven by their trucks. The bridge is scheduled for repair four years from now. The increased miles driven by these timber trucks results in added fuel costs of \$50,000 a month or \$600,000 a year for the company. The company may be willing to contribute 10% of a \$5 million bridge project if that means the bridge will be repaired sooner. If the company must wait four years for the bridge to be repaired, that delay will cost the company \$2.4 million in added fuel costs. However, if the company contributes \$500,000 to assist with the public bridge project it would actually yield a cost savings of \$1.9 million for the company.

In addition to lowering the cost of projects for taxpayers, the addition of the private sector increases the amount of interested parties who are focused on ensuring that these projects are done in a cost effective and timely manner. Greater preference will be given to projects with a high public-private partnership quotient.

REPEAL PREVAILING WAGE

Additional costs are added to projects by requiring all bids be subject to prevailing wage requirements. As a direct result of the prevailing wage requirement, the cost of projects to taxpayers is higher and there is less work accomplished. In the 2015-2017 budget, prevailing wage was repealed for local projects. This proposal includes the complete elimination of prevailing wage requirements. The elimination of prevailing wage will save money and with that savings, allow Wisconsin to engage in additional infrastructure projects.

ELIMINATE 180 DOT POSITIONS

Four years ago the Department of Transportation (DOT) requested and the legislature approved 180 new engineer positions. However, a study conducted by New York University, Tandon School of Engineering for the American Council of Engineering Companies definitively shows that state employees are more expensive than private contractors. When all costs are considered – labor, fringe benefits and overhead costs – the study shows a total cost for a public employee is \$270,802 versus a private design firm employee cost of \$183,164. Some of these additional costs are not immediately seen in a two-year cash basis budget but the state is responsible for the legacy costs. The pension and health care costs remain the responsibility of the state long after the employee leaves state service. The state has been aggressively recruiting private sector engineers to join the state workforce and such strong recruiting efforts have made it difficult for private firms to compete. This proposal has a net reduction in state employees, decreasing the scope and size of government.

ROUNDBOUT MORATORIUM

There has been a great deal of criticism from both the Legislative Audit Bureau (LAB) in the recent DOT audit and the general public that roundabouts have been put in place without taking into consideration public input. This proposal requires roundabouts that are not currently under contract for construction be approved by the county or municipality who has jurisdiction over the highway on which the project is located.



EQUITABLE FEES FOR HYBRID AND ELECTRIC VEHICLES

This proposal collects revenue from the owners of hybrid and electric non-hybrid vehicles to ensure that those owners are also financing, repairing and maintaining our roads in an amount comparable to those who drive other vehicles. Municipalities who currently have a local vehicle registration fee (wheel tax) in place may apply this fee to hybrid and electric non-hybrid vehicles.

SUSPEND LOCAL WHEEL TAX

Recently, a number of local governments have created wheel taxes. Oftentimes the wheel tax is sold as a transportation solution but the money is shifted around within the overall budget so the majority of new wheel taxes are not allocated to transportation. In the most recent election, Milwaukee County voters overwhelmingly rejected an advisory wheel tax by a vote of 72% opposed to 28% in favor.

This proposal would eliminate the ability of a local government to enact a local registration fee for motor vehicles ("wheel tax") unless approved by voters by referendum. Local governments that either have authorized or have enacted a wheel tax would be able to retain the wheel tax. However, any county that first imposed a wheel tax in 2017, that was in effect prior to April 1, 2017, would only be allowed to retain their existing wheel tax if approved by voters by referendum. In addition, allow local governments the authority to impose a separate local registration fee on hybrid and electric vehicles.

ROAD POSTING APPEAL

This proposal gives local businesses the option of appealing to DOT if posted weight limits are lowered. The lower posted weight limit remains in place contingent upon the DOT's review. The review must be completed by DOT within 120 days of the appeal being filed. DOT's review shall focus on ensuring the lower weight limit is appropriate.

LOCAL REFERENDUM

This proposal allows counties to enact up to a .5% increase in the sales tax for purposes of funding local transportation needs. The referendum cannot be for a period to exceed 4 years and can only be enacted two times for a total of 8 years. Municipalities currently with a wheel tax may not utilize the referendum unless the wheel tax is eliminated. Counties enacting the sales tax increase for transportation must maintain the base level of transportation funding and all proceeds from the referendum are built on top of the previous year's base.

FEDERAL SWAP

The federal government is taking our tax dollars and then returning this same money to us with strings attached. The proposed federal swap legislation will substitute some of the

federal money in local transportation programs with existing state transportation money thereby removing burdensome, expensive and superfluous federal regulations from local highway projects.

By increasing the amount of federal transportation dollars spent on federal projects and by replacing federal dollars on local road projects with state dollars, the legislature can ensure that local governments have greater flexibility and lower costs when it comes to maintaining and expanding their local road network. Federal dollars are already used on large mega projects so increasing the amount of federal dollars allocated to those projects does not increase the regulatory or compliance burden associated with federal money.

This proposal provides a four-year phase in for this “swap” of transportation money. To give DOT time to adjust its funding mix for certain projects, the language delays implementation for the first fiscal year (FY 2018), requires DOT to swap 33% of federal funds in local projects for state funds in FY 2019, requires a 66% swap for such funds in FY 2020 and requires a 100% swap for FY 2021 and every year thereafter.

FUND INTEGRITY

Approximately \$40 million is now being transferred annually from the general fund to the transportation fund. As a result of the reforms above, the general fund no longer has to subsidize the transportation fund. This change allows the transportation fund to be self-sufficient and ensures that those using the transportation system are the same parties paying for the transportation system.

FEDERALISM – TOLLING DECISIONS

The federal government exerts a great deal of leverage over states by providing funding or threatening to withhold funding for various types of assistance to state governments. In the event the federal government determines it is optimal to leave it up to individual states to determine what is best for their local needs, this proposal requires the executive branch to seek a change in federal law, or an exemption, that allows Wisconsin to pursue toll roads as a possible transportation funding source. Should the situation present itself that Wisconsin is granted permission to utilize toll roads, this proposal requires approval by the Senate and Assembly Transportation Committees, the Joint Finance Committee, the full Assembly and full Senate and finally the Governor.

PLANNING FOR FEDERAL INFRASTRUCTURE INVESTMENT

There is considerable momentum in Washington, D.C. for transportation infrastructure reform. As we have seen with prior federal transportation awards, there are often long delays between when the awards are made to the states and implementation – the delay is primarily because the states are not prepared. Wisconsin will not be unprepared. This

proposal requires DOT to develop a list of priority infrastructure projects for the state of Wisconsin. The highest priority will be given to projects based on the readiness of the project and the condition of the infrastructure. DOT shall indicate priority based on the speed with which the project can proceed and the importance of the project to Wisconsin's overall economy. Wisconsin will be the first state ready to go when the money becomes available from the federal government.

ADOPT LAB RECOMMENDATIONS

A report was released in January 2017 by the Legislative Audit Bureau (LAB) highlighting inefficient practices and other issues within DOT. This proposal incorporates various recommendations made by LAB in the audit as drafted in Assembly Bill 142 and Senate Bill 85 except for the recommendations on construction manager/general contractor (CMGC).



Report 142
January 2017

State Highway Program



TAX REFORMS

FLAT TAX

Wisconsin’s income taxes discourage additional work at a time in which there is a workforce shortage. Our tax code discourages work because any additional income is taxed at a higher rate. This reality, coupled with the elimination of other government benefits as income increases, discourages additional investment in both time and capital into Wisconsin’s economy. This proposal uses economic growth and the reduction or elimination of tax credits or deductions over time to move Wisconsin to a flat 3.95% income tax.

2011	4.60%	6.15%	6.50%	6.75%	7.75%
Current Rates	4%	5.84%	6.27%		7.65%
2017*			6.27%		7.65%
2018*	3.95%	4.07%	6.27%		7.20%
2019*	3.95%		6%		7%
2020*	3.95%		5.5%		6.75%
2021*	3.95%		5%		6.5%
2022*	3.95%		4.5%		6.25%
2023*	3.95%				6%
2024*	3.95%				5.6%
2025*	3.95%				5.2%
2026*	3.95%				4.8%
2027*	3.95%				4.4%
2028*	3.95%				
2029*	3.95%				

**The final year of the flat tax and rate is not subject to change but the transition of rates per year may change based on final Legislative Fiscal Bureau analysis.*

The road to a flat tax eliminates and reforms certain tax credits in order to pay for the flat tax over time and simplify the tax code. The following credits will be modified in order to assist in the road to a 3.95% flat tax:

First Dollar Credit. Created in the 2007 biennial budget, this credit was first established for property taxes levied in 2008 and payable in 2009. The First Dollar Credit inserts a progressive tax mechanism into the property tax even though the Uniformity Clause of

the Wisconsin State Constitution requires taxes to be levied uniformly. This proposal eliminates the state's First Dollar Credit over the course of three years beginning in 2019. The elimination of the credit also assists in lowering Wisconsin's GAAP deficit.

Itemized Deduction Credit. The Itemized Deduction Credit will be lowered from a 5% calculation to 2% calculation in order to assist in paying for the collapsing of the brackets.

Marriage Credit. The Marriage Credit does not promote marriage, but instead grants a credit when both spouses are working. The unintended consequence of the credit is families' taxes are increased when a spouse decides to stay home with children or can't work do to medical issues. The proposal eliminates the credit in order to promote tax code simplicity, fairness and assist in paying for the flat tax.

Property Tax / Rent Credit. Allowing rent to be deducted on an individual's return and allowing the property owner to deduct the property tax results in the same expense being deducted twice. The proposal would repeal the credit for renters, effective in tax year 2019.

Working Families Credit. This credit was created in order to serve as a bullet point on a press release. Although Wisconsin is full of working families, less than 1% of Wisconsin filers qualify for this narrow credit. The elimination of this credit simplifies the tax code.

ELIMINATE STATE PROPERTY TAX

The majority of residents' property tax bills are associated with local units of government. Property tax relief provided to date has been accomplished by increasing funding to K-12 schools and technical colleges and then requiring those units of governments to provide a corresponding reduction in the property tax levy. The elimination of the state property tax removes the state from levying a property tax, promotes simplicity, lowers the overall property tax burden and results in \$180 million in property tax relief over the biennium.

ELIMINATE THE ELECTRONICS RECYCLING FEE

The electronics recycling fee is a fee unique to Wisconsin. The fee calculation is complicated and creates onerous paperwork. The fund associated with the fee is solvent and the fee is no longer required.

ELIMINATE THE ALTERNATIVE MINIMUM TAX

Wisconsin is one of just 6 states with an Alternative Minimum Tax (AMT). Our tax code is already complicated but Wisconsin compounds it by having a second tax code. Most people, including many elected officials, have no idea how Wisconsin's complex tax code even works but session after session the legislature continues to enact catch-all provisions

that reduce or eliminate tax benefits that they originally thought were a good idea. This proposal eliminates the Alternative Minimum Tax.

ELIMINATE THE INTERNET TAX

Wisconsin is one of only 5 states in the country with an internet access tax. The tax makes access to information, education and connecting to loved ones more difficult and expensive. Congress, under the leadership of Speaker Paul Ryan, now prohibits all states from taxing internet access effective October 1, 2015. The law also grants an extension to the handful of states which currently impose this tax. The temporary extension runs until a firm end date of June 30, 2020.

ELIMINATE AMBULATORY SURGICAL CENTER (ASC) ASSESSMENT

The 2009-2011 budget created the ASC Assessment. The assessment raises the price of care in more than two-thirds of ASC locations by increasing overall expenses. The elimination of the assessment removes another tax and encourages low cost healthcare providers to increase investments in Wisconsin.

CIGARETTE TAX UNIFORMITY

Under current Wisconsin law, most cigarettes are taxed at a rate of \$2.52 per pack (126 mills per cigarette). However, certain cigarettes wrapped in brown paper instead of white paper are taxed at the lower rate of \$0.78 per pack. This proposal taxes brown paper cigarettes at the same rate as other cigarettes and uses this revenue to pay for tax cuts. Changing the classification of cigarillos to brown cigarettes is expected to yield a net increase of \$7.0 million per fiscal year (\$4.7 million up to \$11.7 million).

ADOPT INTERNAL REVENUE CODE PROVISIONS

- Allow an individual to make a tax free distribution from an individual retirement account to a qualified charitable organization.¹
- Accept all IRC conformity changes as presented in the budget proposal.

We cannot message our way to prosperity. We know what works. Big government, high taxes and poor infrastructure lead to capital fleeing Wisconsin. When capital and our citizens leave our state, we all lose. This plan does not create a transportation or tax utopia, but is the boldest tax and transportation reform in decades. It's time to fix our roads, reform our tax code and lower Wisconsin's tax burden. We've made significant progress since 2011; now it's time to be even bolder and embrace long-term solutions.

¹ 2017 AB 176