CHAPTER 4

CORPORATE INCOME TAXES

Introduction

At 7.9 percent, Wisconsin's corporate income tax rate ranks high nationally despite being in the middle of the pack compared to neighboring states.

To ameliorate some of the high statutory tax burden, Wisconsin relies heavily on corporate tax credits and deductions. In many states, such incentives mitigate tax burdens for select industries and activities but put upward pressure on the overall rate.

While many states have reduced their reliance on corporate taxes in recent years due to their revenue volatility and detrimental impact on business investment, not once since the inception of Wisconsin's corporate income tax has the rate been reduced. As such, the state has the opportunity to improve its attractiveness to business investment of all types by moving toward a system with a broader base and lower rates.

In this chapter, we provide a broad overview of Wisconsin's corporate income tax, outline issues to consider regarding the current system, and provide options for reform.

Overview of Wisconsin's Corporate Income Taxation

The Badger State was the first state to enact a corporate income tax, creating a corporate income tax and an individual income tax at the same time in 1911 under the Wisconsin Income Tax Law.[66] Wisconsin's corporate income tax was originally imposed with rates ranging from 2 to 6 percent, though today it uses just one flat rate, albeit a higher one of 7.9 percent (Table 4a).

TABLE 4a.

Wisconsin Corporate Tax Rates, 1913-Present

Bracket	1913-1953	1954-1970	1971	1971-1980	1981-Present
$0-1,000	2%	2%	2.1%	2.3%	7.9%
$1,001 - $2,000	2.5%	2.5%	2.7%	2.8%	7.9%
$2,001 - $3,000	3%	3%	3.2%	3.4%	7.9%
$3,001 - $4,000	3.5%	4%	4.3%	4.5%	7.9%
$4,001 - $5,000	4%	5%	5.3%	5.6%	7.9%
$5,001 - $6,000	5%	6%	6.4%	6.8%	7.9%
$5,001 - above	6%	7%	7.4%	7.9%	7.9%

Source: Wisconsin Department of Revenue.

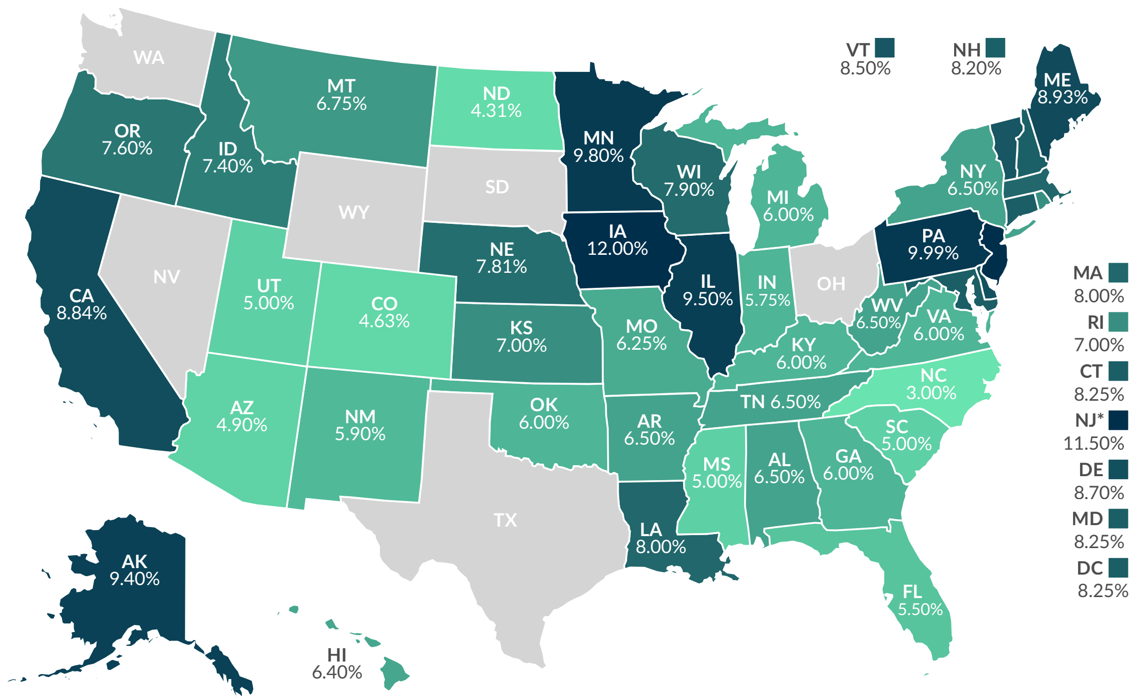
66 Liz Emanuel and Richard Borean, "When Did Your State Adopt Its Corporate Income Tax?" Tax Foundation, June 19, 2014, https://taxfoundation.org/when-did-your-state-adopt-its-corporate-income-tax/; Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," Wisconsin Department of Revenue, Division of Research and Policy, June 18, 2018, 20, https://www.revenue.wi.gov/DORReports/CorpIncFranchTax.pdf, and Kossuth Kent Kennan, "The Wisconsin Income Tax," *The Quarterly Journal of Economics* 26, no. 1, November 1911, 169-78, https://www.jstor.org/stable/1884532.

Wisconsin's corporate tax rate is in the middle of the pack compared to its neighbors, with Iowa, Minnesota, and Illinois having higher top rates of 12.0 percent, 9.8 percent, and 9.5 percent, respectively, but with Indiana and Michigan featuring lower top rates of 6 percent and 5.75 percent, respectively (Figure 1a). Nationally, Wisconsin's 7.9 percent rate is on the high side, with just 15 states and D.C. topping out at higher rates, and many of those states being home to sizable cities with legacy corporate capital formation.

Notably, Wisconsin additionally levies an "Economic Development Surcharge" of 3 percent of gross tax liability on firms with gross receipts above $4 million. The surcharge is capped at $9,800.[67]

FIGURE 4a.

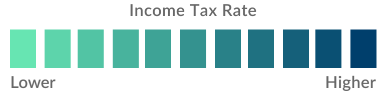
Top Marginal Corporate Income Tax Rates as of July 1, 2018



Note: (*) Nevada, Ohio, Texas, and Washington do not have a corporate income tax but do have a gross receipts tax with rates not strictly comparable to corporate income tax rates. Arkansas has a "benefit recapture," by which corporations with more than $100,000 of taxable income pay a flat tax of 6.5% on all income, not just on amounts above the benefit threshold. Connecticut's rate includes a 10% surtax, which effectively increases the rate from 7.5% to 8.25%. Surtax is required by businesses with at least $100 million annual gross income. Illinois' rate includes two separate corporate income taxes, one at a 7.0% rate and one at a 2.5% rate.

Source: State tax statutes, forms, and instructions; Bloomberg BNA.

Top State Marginal Corporate Income Tax Rate



Forty-four states levy a corporate income tax, most with flat rate structures like Wisconsin's. Since 2008, 15 states and the District of Columbia have cut corporate income tax rates, and Michigan shifted from a gross receipts tax to a traditional corporate income tax.[68] In Wisconsin, by contrast, corporate income taxes have never been cut in the history of the tax; the current top rate has been the same since 1971, when the top marginal rate was first raised to 7.9 percent.[69]

67 Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," 8. Revenues from the surcharge fund programs of the Wisconsin Economic Development Corporation (WEDC).

68 See Joseph Bishop-Henchman, "Trend #3: Corporate Tax Reductions, Top 10 State Tax Trends in Recession and Recovery, 2008 to 2012," Tax Foundation, June 13, 2012, http://taxfoundation.org/article/trend-3-corporate-tax-reductions; *Facts & Figures: How Does Your State Compare?* Tax Foundation, multiple years.

69 Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes," 20.

Reductions in corporate rates elsewhere reflect a trend toward decreased reliance on a highly volatile tax imposed on a declining amount of taxable income, and, in some instances, an effort to simplify the tax structure by broadening the base and lowering the rate. Corporate income tax reliance is also in decline across the country as more businesses choose to structure as S corporations and limited liability corporations (LLCs), single sales factor apportionment becomes more common, and the tax base is eroded by special credits and deductions.

Economists generally agree that corporate income taxes are not borne by businesses but are instead passed on to consumers in the form of higher prices, shareholders in the form of lower dividends, or labor in the form of lower wages.[70] Corporate income taxes also tend to be complex and impose substantial administrative burdens for both payers and the government, and this complexity has not abated as the tax base has eroded. Finally, revenue volatility necessarily follows from the nature of the tax, since in periods of economic distress, many companies may post losses and thus lack exposure to a corporate income tax (as evidenced below in Wisconsin in Figure 4b).

Comparing Wisconsin's Corporate Taxes Regionally and Nationally

Wisconsin's corporate tax system ranks toward the bottom of the pack nationally in terms of competitiveness, coming in at 35th on our *State Business Tax Climate Index*, a measure of both tax rates and tax structure. Compared to its neighboring states, Wisconsin outperforms Iowa, Minnesota, and Illinois but comes in behind Michigan and Indiana (Table 4b).

TABLE 4b.
2019 State Business Tax Climate Index **Corporate Income Tax Component Rankings, Wisconsin and Nearby States**

State	Component Ranking
Illinois	39
Indiana	18
Iowa	48
Michigan	11
Minnesota	42
Wisconsin	35

Source: Tax Foundation, 2019 *State Business Tax Climate Index*.

70 *See, e.g.*, Robert Carroll, *Corporate Taxes and Wages: Evidence from the 50 States*, TAX FOUNDATION WORKING PAPER NO. 8 (Aug. 2009), http://taxfoundation.org/article/corporate-taxes-and-wages-evidence-50-states. *See also* Stephen J. Entin, "Labor Bears Much of the Cost of the Corporate Tax," Tax Foundation Special Report 238, Oct. 24, 2017, https://taxfoundation.org/labor-bears-corporate-tax/.

Corporate Income Tax Collections

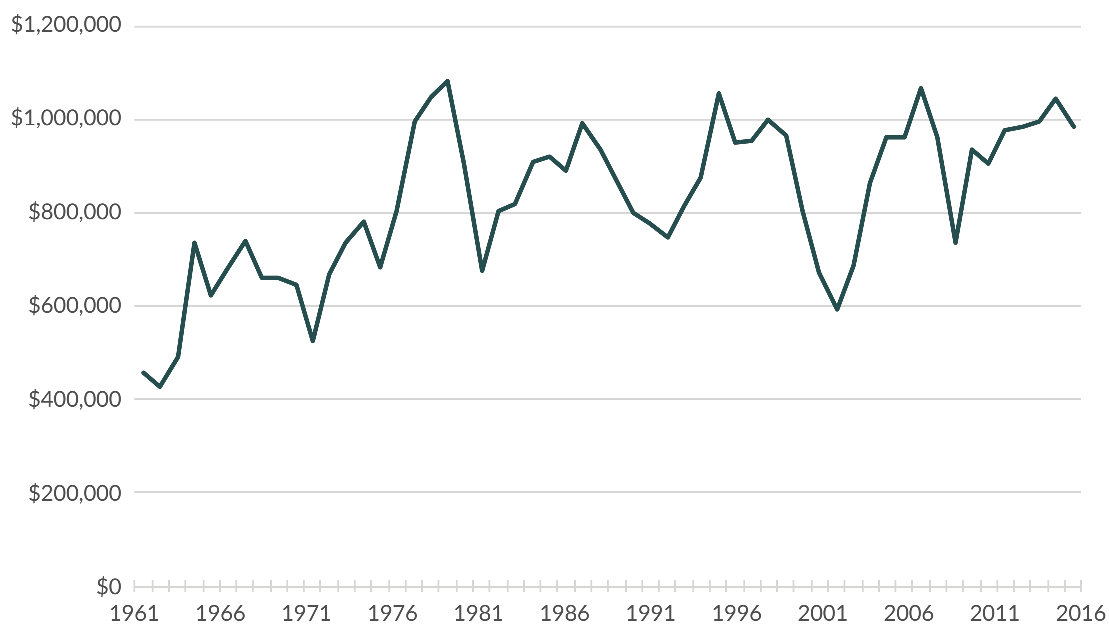
In fiscal year 2016, the corporate income tax brought in $986 million. Wisconsin's corporate income tax collections per capita are on the high side, ranking 14th in the nation.[71]

Corporate income taxes are among the most volatile sources of state revenue, since many companies may generate little or no net income during economic downturns. While practically all revenue streams are cyclical, with collections lower during periods of economic distress, corporate income taxes experience particularly deep troughs. Property values may decline during a recession, but they are rarely wiped out, limiting how low property tax collections can go. Similarly, consumption patterns may decline, leading to lower sales tax revenues when the economy is slowing, but sales can only drop so far. Many companies' net income, by contrast, can bottom out or even go into negative territory. As such, corporate tax collections tend to be hyper-cyclical and highly volatile, spiking sharply in good years and collapsing in bad ones.

Figure 4b shows that Wisconsin corporate income tax collections took a significant hit during the early 2000s' recession and in the Great Recession, just at the time when Wisconsin most needed revenue stability.

FIGURE 4b.

Wisconsin Corporate Income Tax Collections, 1961–2016 (in Thousands of 2016 dollars)



Note: Dollar amounts are inflation-adjusted based on the annual average Consumer Price Index for All Urban Consumers (CPI-U) with a 2016 base year.

Source: Census Bureau, *State and Local Government Finances*; Bureau of Labor Statistics, *Consumer Price Indexes* (All Urban Consumers).

71 Morgan Scarboro, *Facts & Figures 2018: How Does Your State Compare?* Tax Foundation, March 21, 2018, Table 16, https://taxfoundation.org/publications/facts-and-figures/.

Corporate Income Tax Expenditures

Deductions, credits, and exemptions all serve to reduce tax liability, but they do so in distinct ways that are important to bear in mind while attempting any comparison. Deductions reduce taxable income by a given amount, whereas credits are a subtraction against tax liability. Imagine, for instance, a corporate taxpayer with $50,000 in Wisconsin corporate income tax liability. A $5,000 credit will reduce tax liability to $45,000. A $5,000 deduction will reduce tax liability by less than $500, by removing the tax only on that $5,000. An exemption, meanwhile, excludes certain revenue from the tax rolls altogether.

Wisconsin offers a range of deductions, credits, and exemptions against corporate income tax liability. By far the most significant of these are the Manufacturing and Agriculture Credit (MAC), the Enterprise Zones Jobs Credit, and the Research Expenditures Credit (see Table 4c).

The MAC provides a credit equivalent to 7.5 percent of income that is derived from agricultural or manufacturing activities.[72] Though the credit is nonrefundable, for many firms it can be significant, potentially wiping out most corporate tax liability. The MAC is also available to other business forms like S corporations and LLCs that file returns through the individual income tax.

The Enterprise Zones Jobs Credit is administered by the Wisconsin Economic Development Corporation (WEDC). It is awarded to firms that locate within one of 30 designated geographical areas and make significant capital or labor investments in those areas. The credit is quite intricate, with five components offering tax reductions for payroll growth, job training expenses, capital expenditures, and goods and services purchased from Wisconsin vendors. Because the credit is refundable, businesses for which the credit is larger than their entire tax liability receive a check back from the Department of Revenue.[73]

The Research Expenditures Credit is awarded to firms based on their research expenses. Firms receive a 5.75 percent credit against expenses that are above 50 percent of the firm's average research expense over the previous three years. The credit is nonrefundable.[74]

The total revenue reduction from the totality of Wisconsin's nonrefundable corporate tax credits was an estimated $125.5 million in FY 2016, and an additional $50 million was estimated to have been spent on refundable corporate tax credits that year. For context, the corporate tax collected $963 million that fiscal year, and so corporate tax credits together represent approximately 15 percent of Wisconsin's corporate tax base.[75]

72 Ibid., 52.
73 Ibid., 48.
74 Ibid., 45-6.
75 Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017, https://www.revenue.wi.gov/DORReports/17sumrpt.pdf.

TABLE 4c.

Corporate Income Tax Credits in Excess of $1 Million

Credit	Amount in FY16
Manufacturing and Agriculture Credit	$58,000,000
Enterprise Zones Jobs Credit	$44,400,000
Research Expenditures Credit	$36,300,000
Supplement to Federal Historic Rehabilitation Credit	$9,000,000
Super Research Credit Carryforward	$8,000,000
Economic Development Credit	$7,000,000
Jobs Tax Credit	$4,800,000
Engine Research Expense Credit	$3,000,000
Manufacturing Investment Credit	$1,600,000
Development Zone and Development Opportunity Zone Credits	$1,000,000

Source: Wisconsin Department of Revenue and Department of Administration, "Summary of Tax Exemption Devices," February 2017.

In our discussions around the state, it became clear to us that for many businesses, the MAC and other incentives make the 7.9 percent corporate rate tolerable. A rate that high without the MAC or something comparable would make many business activities unsustainable. That said, incentives generally are not good long-term economic development due to their inefficiencies. By lowering tax costs for targeted industries or rewarding particular business activities, they can yield higher employment or greater investment in those sectors, but that does nothing for businesses in other sectors. A well-structured tax code with a broader base—eliminating many of the incentives—and a lower rate would do far more to encourage job creation and economic growth. In Wisconsin's case, the MAC reduces business tax burdens for manufacturing and agriculture businesses while new and fledgling businesses must face the full freight of the state's high tax rates.

Policy options for tax incentives vary. The Pew Center on the States has done a very good job in recent years assisting states in defining goals for tax incentives and developing metrics to analyze effectiveness. Some states like North Carolina and Indiana have pursued large reductions or elimination of tax incentives coupled with substantial reductions in the corporate tax rate, replacing a picking-winners-and-losers-through-the-tax-code approach with a broad-based and competitive tax code for all. Indiana in particular has paired eliminations of ineffective corporate tax incentives with eliminations of ineffective individual tax incentives, while reducing both corporate and individual tax rates.

Structural Elements

Net Operating Loss Carrybacks and Carryforwards

The corporate income tax is designed to tax only the profits of a corporation. However, a yearly profit snapshot may not fully capture a corporation's true profitability. For example, a corporation in a highly cyclical industry may look very profitable during boom years but post substantial losses during bust years. When examined over the entire business cycle, the corporation may actually have only a moderate profit margin.

Although corporate income tax liability is determined on an annualized basis, business cycles do not follow the calendar. To mitigate this effect, states (along with the federal government) allow corporations to deduct losses from previous years and future years to offset current taxes owed. These net operating loss (NOL) "carrybacks" and "carryforwards" smooth out tax obligations over time, ensuring that industries with cyclical income are not at a competitive disadvantage against industries with more consistent and stable revenue streams.

The deduction for net operating losses helps ensure that, over time, the corporate income tax is a tax on average profitability. Without the NOL deduction, corporations in cyclical industries pay much higher taxes than those in stable industries, even assuming identical average profits over time.

There are two important variables of a state's NOL provisions: the number of years allowed for carrybacks and carryforwards, and caps on the amount of carrybacks and carryforwards. The maximum that any state allows for carrybacks is three years, with no cap (that is, an unlimited dollar amount allowed). Among the states that allow carrybacks, the most common time span is two years with no cap. The maximum carryforward given in any state is 20 years, again with no cap (most states allow either 15 or 20 years, though 20 is more desirable). The longer the overall time span, the higher the probability that the corporate income tax is being levied on the corporation's average profitability. Wisconsin allows 20 years of carryforwards but does not allow for any carrybacks.

The Tax Cuts and Jobs Act (TCJA) changed the way the federal government handles NOLs. Previously, the federal government allowed two years of carrybacks and 20 years of carryforwards. Under the new law, the federal government will now allow carryforwards for an unlimited number of years, but they are capped at 80 percent of tax liability in a given year. Carrybacks are no longer allowed in the federal corporate tax.[76]

Wisconsin should consider adhering to this new federal standard for simplicity and conformity with the new code.

76 Jared Walczak, "Tax Reform Moves to the States: State Revenue Implications and Reform Opportunities Following Federal Tax Reform," Tax Foundation, Jan. 31, 2018, https://taxfoundation.org/state-conformity-federal-tax-reform/.

Apportionment and Throwback

When businesses operate in more than one state, income must be apportioned among those states for tax purposes. The legal term for whether a state has the power to tax is *nexus*, a standard which typically requires a business to have some physical presence, either property or employees, in a state. The determination of the amount of that business's income subject to a given state's corporate income tax is known as *apportionment*.

States apportion business profits based on some combination of the percentage of company property, payroll, and sales located within their borders. Traditionally, states adopted an evenly weighted three-factor apportionment formula of property, payroll, and sales, meaning that property, payroll, and sales are taken into account equally when determining income apportionment. Today, states have moved increasingly toward weighting their sales factor more heavily, with many states even employing single sales factor apportionment, meaning the only determinant of the percent of firm profits subject to tax within the state is the percent of sales into that state.

Wisconsin employs a single-sales formula for most businesses, though it occasionally employs different weighting that can include property or payroll factors for some interstate firms like pipelines and telecommunications.[77]

Single-sales factor treatment is beneficial for firms that export to other states, as in-state sales are the only sales that weigh into the apportionment ratio. Additional capital improvements in a headquarters or manufacturing plant, as well as equipment located in Wisconsin, do not directly expose a company to increased Wisconsin corporate tax liability.

However, the efforts that Wisconsin makes to minimize the harm for exporters are undone by its throwback rule. Because each state has a different apportionment method, sometimes certain income goes untaxed. Throwback rules, which exist in 22 states and the District of Columbia, throw back this so-called "nowhere income" into the state's taxable base. In many cases, multiple states claim the right to tax the same income, introducing added complexity and double taxation into the tax code.[78]

77 Zachary Petersen, "Wisconsin Corporate Income and Franchise Taxes."
78 See Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, *2019 State Business Tax Climate Index*, Tax Foundation, Sept. 26, 2018, https://taxfoundation.org/state-business-tax-climate-index-2019/.

Corporate Income Tax Reform Solutions

Our corporate income tax reform solutions would make Wisconsin more competitive in the region and nation and more attractive for business investment. These policies eliminate the "sticker shock" associated with Wisconsin's high statutory income tax rates and prioritize improving the state from a system of taxation that is only competitive for certain industries, positioning the state for future growth.

Conform Treatment of Net Operating Losses

Wisconsin should conform to the new federal rules on NOLs, allowing carryforwards for an unlimited number of years, with the deduction capped at 80 percent of tax liability each year. This linking to the federal code would improve simplicity in the corporate income tax and improve NOL treatment for firms with particularly long time horizons.

Eliminate the Throwback Rule

Wisconsin taxes the "nowhere income" of corporations through its throwback rule, which adds unneeded complexity to the state's corporate income tax code and creates a potential for double taxation. Wisconsin should eliminate its throwback rule.

Couple to Federal Expensing Rules

Federal tax reform significantly improved the ability of businesses to recover the costs of their investments by allowing 100 percent bonus depreciation for assets with cost recovery periods of 20 years or less. Through 2022, businesses can immediately deduct the full cost of eligible investments, such as the purchase of machinery and equipment, just as they would with any other business expense, rather than the former practice of stretching deductions over many years.

To date, 14 states piggyback off the federal provision, applying the new federal 100 percent bonus depreciation rules to their own corporate tax practices, but Wisconsin is not yet among those states.

Conforming to federal full expensing provisions is one of the most growth-friendly tax policies Wisconsin can adopt, as it would eliminate disincentives for investment and growth that are currently baked into the tax code.

Lower Corporate Tax Rate

Finally, we propose lowering Wisconsin's corporate income tax rate in four options listed in the executive summary. Option A would reduce the rate from 7.9 percent to 7 percent, along with adoption of a low, flat individual income tax and an increased sales tax. Option B would reduce the corporate tax rate to 4.6 percent with across-the-board income tax cuts. Option C would repeal the corporate income tax completely, along with a greatly expanded sales tax base and across-the-board income tax cuts. Option D reduces the corporate income tax to 4 percent, along with a modest reduction to the income tax and increase to the sales tax.

Repeal the Economic Development Surcharge

The Economic Development Surcharge, which is tacked on after corporate tax liability for firms with gross receipts above $4 million, is a special tax levy with collections dedicated to the Wisconsin Economic Development Corporation (WEDC) instead of the state's general fund. While this tax is capped at $9,800 to prevent some businesses from having to pay drastically more than others, it is nonneutral in that it only applies to businesses with gross receipts above a certain amount, raising effective corporate rates even higher for those firms. A simpler, more neutral tax structure would avoid instituting narrow new taxes and would instead use broader-based taxes to fund all state priorities.