

#### Introduction

Wisconsin's tax and budget system includes some additional considerations that are outside the topics already discussed but merit attention in reform conversations. The most formidable of these is the state's transportation system, where the value of the state's gas tax is falling behind historical averages while spending is increasing. This chapter also suggests Wisconsin explore tolling as another way to generate adequate revenue for transportation.

Wisconsin's unemployment insurance tax system is uncompetitive with high rates and a complex structure. The state's top rate is the fifth highest nationally and includes an additional surtax on firms. An uncompetitive unemployment insurance structure makes it difficult for in-state employers to expand or innovate as firms that struggle are the firms that are punished the most.

Finally, we discuss the tax reform practice of using revenue triggers to phase in tax reforms so that revenue stability is maintained while moving the state toward a more comprehensive tax system. Several states have implemented revenue triggers and provide ample examples to craft a trigger tailored for Wisconsin.

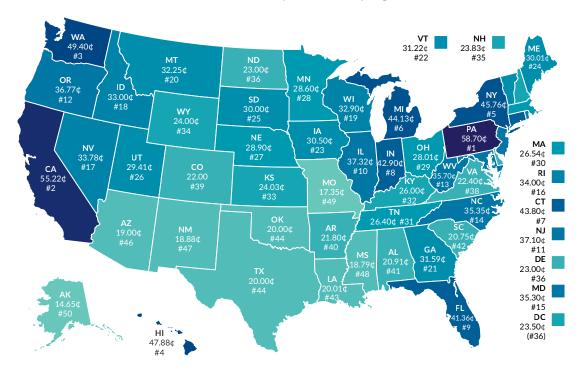
## **Transportation Funding in Wisconsin**

The Wisconsin gasoline tax today stands at 32.9 cents per gallon (cpg), the 19th highest rate in the country (Figure 7a). Because state motor fuel taxes are usually imposed as an excise of a given amount per gallon, and tend not to be indexed for inflation, tax collections tend to decline in real terms over time. Wisconsin is no different in this regard, as shown in Figure 7b.

#### FIGURE 7a.

#### **State Gasoline Tax Rates**

Total State Taxes and Fees on Gasoline, as of July 2018 (cents per gallon)

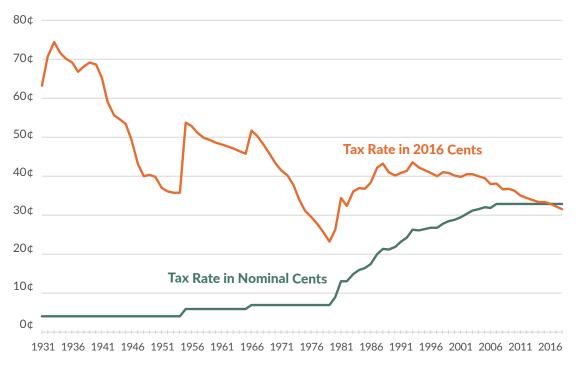


Notes: These rates do not include the 18.40 cent/gallon federal excise tax on gas. The American Petroleum Institute (API) has developed a methodology for determining the average tax rate on a gallon of fuel. Rates may include any of the following: excise taxes, environmental fees, storage tank taxes, other fees or taxes, and general sales tax. In states where gasoline is subject to the general sales tax, or where the fuel tax is based on the average sale price, the average rate determined by API is sensitive to changes in the price of gasoline. States that fully or partially apply general sales taxes to gasoline are California, Connecticut, Georgia, Illinois, Indiana, Michigan, and New York. D.C.'s rank does not affect states' ranks, but the figure in parentheses indicates where it would rank if included.

Source: American Petroleum Institute.



FIGURE 7b. Wisconsin Gasoline Tax Rate, 1931-2018 (Cents per Gallon)



Note: The state also charges a 2 cent per gallon tax for underground storage of fuels. It is not included above. Source: Wisconsin Statutes: Bureau of Labor Statistics. Consumer Price Indexes (All Urban Consumers).

Because the state has raised its gas tax rate infrequently, the value of the tax has declined in real terms. In 1933, the tax peaked at 77.6 cents per gallon in inflation-adjusted terms. While Wisconsin has changed its rate several times since then, the state hasn't raised the rate since 2006. The current rate of 30.9 cpg is now well below the state's average rate. Since World War II, the average inflation-adjusted rate is 40.6 cpg. Not adjusting the rate makes it more difficult to finance transportation spending, as the gas tax revenue doesn't go as far as it could in the past.

Additionally, cars are becoming more fuel efficient, meaning they need fewer gallons of gas to travel the same distance. That further erodes the value of the gas tax, since the tax is assessed on the number of gallons dispensed.

Gas taxes are not a perfect option for funding transportation investments but do serve as a reasonable addition to a mix of transportation funding options.

#### Minimum Markup on Gasoline

In addition to the state's excise tax on gasoline sales, the state also mandates the markup that retailers and wholesalers must charge on the product.

In 1939, the Unfair Sales Act, commonly referred to as the "minimum markup law," was adopted in Wisconsin. Originally designed to prevent businesses from using predatory pricing to defeat their competitors and gain a monopoly, this Depression-era law remains on the books to this day, artificially inflating gas prices beyond what most retailers would like to charge.

Specifically, the Unfair Sales Act prevents Wisconsin brick-and-mortar stores from selling any good "below cost," and the law outlines a specific markup formula for gasoline, tobacco, and alcohol. 135 The markup is calculated by adding 2 cents to the invoiced price (with revenue used for transportation funding) before adding federal, state, and local taxes. After taxes are added, wholesalers are required to mark up the price by 3 percent, and retailers by an additional 6 percent, for a total markup of 9.18 percent. Currently, less than half the states have this antiquated policy. 136

Proponents of minimum markup policies argue that they prevent retailers and gas stations from pricing their products below value to attract consumers and eliminate competition (predatory pricing). But there is little evidence that minimum markup polices are successful at accomplishing that goal. A recent study, for example, compared the number of small gas stations in states with and without minimum markup laws. The authors argue that "the presence of a minimum markup law has no impact on the number of gas stations in a state." 137 They continue arguing more strongly that the provision "does nothing to achieve its ostensible goal of protecting small independent retails from excessive competition."138 Instead, the provision "increased the profit margin"139 for gas stations, meaning this law results in higher prices for consumers.

### **Highway System in Wisconsin**

Wisconsin's Department of Transportation is responsible for maintaining 12,000 miles of state highways. In the 2015-2016 fiscal year, the state spent more than \$2 billion on construction, planning, maintenance, and other expenses. <sup>140</sup> From fiscal year 1996-97 to fiscal year 2015-16, spending by the Department of Transportation increased by 190 percent.<sup>141</sup> Even with the increase, the state has inadequate funding for transportation. In a 2013 report, it was estimated that the Department of Transportation would need annual increases of \$1.3 billion from 2014 to 2023 to keep pace with the state's maintenance needs.142

<sup>135</sup> Wisconsin Stats. 100.30.

<sup>136</sup> Will Flanders and Ike Brannon, "A Policy in Search of a Problem," Wisconsin Institute for Law & Liberty, May 2017, 4.

<sup>137</sup> Ibid, 11.

<sup>138</sup> Ibid, 11.

<sup>139</sup> Ibid. 11.

<sup>140</sup> Wisconsin Legislative Audit Bureau, "State Highway Program," Report 17-2, January 2017, https://legis.wisconsin.gov/lab/media/2591/17-2full.pdf.

<sup>141</sup> Ibid, 3.

<sup>142</sup> Mark Sommerhauser, "Wisconsin's Transportation-Funding Problem: Possible Solutions; and How We Got Here," Wisconsin State Journal, Jan. 22, 2017, https://madison.com/wsj/news/local/govt-and-politics/wisconsin-s-transportation-funding-problem-possible-solutions-and-howwe/article d731ea7f-fd53-5907-92f6-813406b8b8f8.html.

Over the past decade, the condition of the Wisconsin state highway system has worsened. In 2010, 53.5 percent of state highways were ranked in "good condition," compared to 41 percent in 2015. <sup>143</sup> Compared to its neighboring states, Wisconsin's road condition was "considerably lower" in 2014.144

As those two facts illustrate, Wisconsin is not necessarily the most cost-effective in its management of the state's road funding. A report from the Reason Foundation said Wisconsin had the 38th best performance and cost effectiveness of any state in its oversight of the highway system. The report noted that Wisconsin's per mile spending increased as the condition of roads worsened. 145

#### **Tolling Offers a New Revenue Source**

The state should explore raising its gas tax to restore the inflation-adjusted value of the revenue source, as well as tie the rate to inflation so future adjustments happen automatically. But that change should not be the only one explored by policymakers in the state. Tolling is another smart solution to generating the revenue needed for transportation maintenance and expansion. 146 The difficulty, however, is that tolling on interstate highways requires federal authority. While the federal government has created several pilot programs to expand the use of tolling, approval is difficult to achieve. 147

## **Unemployment Insurance Taxes**

Wisconsin's unemployment insurance (UI) tax ranks just above Illinois among the 10 lowest-ranked UI tax systems on our State Business Tax Climate Index, reflecting high rates and an uncompetitive structure. By contrast, Minnesota and Iowa's UI systems rank in the middle of the pack, while Indiana's ranks 11<sup>th</sup> best in the nation.

TABLE 7a. 2019 State Business Tax Climate Index **Unemployment Insurance Component Rankings** 

Wisconsin and Neighboring States	
State	Component Ranking
Wisconsin	41st
Illinois	42nd
Indiana	11th
Iowa	33rd
Michigan	49th
Minnesota	25th

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

<sup>143</sup> Ibid. 4.

<sup>145</sup> M. Gregory Fields, Baruch Feignebaum, and Spence Purnell, "Ranking the Best, Worst, Safest, and Most Expensive State Highway Systems—The 23rd Annual Highway Report," Reason Foundation, Feb. 8, 2018, https://reason.org/policy-study/23rd-annual-highway-report/.

<sup>146</sup> Robert Poole Jr., "Rebuilding and Modernizing Wisconsin's Interstates with Toll Financing," Badger Institute 24, no. 7 (October 2011), https://www.badgerinstitute.org/Reports/2011/Rebuilding-and-Modernizing-Wisconsins-Interstates-with-Toll-Financing.htm.

<sup>147</sup> Mike Nichols, "Look down the road in transportation funding debate," Badger Institute, July 19, 2017, https://www.badgerinstitute.org/ Commentary/Look-down-the-road-in-transportation-funding-debate.htm.

UI taxes are unique, as rates are computed for each company based on their characteristics, rather than being applied at a uniform rate (or rate schedule) on all businesses. Each year, the Wisconsin Department of Workforce Development computes a contribution tax rate for each employer based on the employer's "experience" in hiring and employment retention. Firms that lay off more workers pay higher rates to approximate their usage of the unemployment compensation system. This tax is not levied on all employee compensation, but on the taxable wage base, which is presently \$14,000 per employee.

Under current law in Wisconsin, firms pay rates between 0.05 percent and 12 percent on the taxable wage base, yielding high effective tax rates compared to most states.

Before employers can qualify for an experience rating, they must endure a waiting period. Wisconsin's three-year waiting period is among the longest; only Nevada's waiting period is longer, at 3.5 years, while 34 states have waiting periods of less than three years. 148 During this waiting period, new employers pay a set "new employer" rate, which is often higher than what they will later pay.

Unlike other states, Wisconsin uses a two-tiered UI tax rate system for new employers, injecting additional complexity into an already complicated tax structure. New employers with total taxable payroll lower than \$500,000 pay a lower-rate UI tax, while those with taxable payroll greater than \$500,000 pay a higher-rate tax. The new employer rate is consistent across every industry except construction, to which a higher rate is applied. 149

Other factors serve to ratchet up liability—even for employers with solid track records based on the state of the economy and the solvency of the unemployment compensation fund. If the state is forced to borrow from the federal government to make payments, moreover, businesses in Wisconsin are responsible for an additional "interest factor." Surcharges and solvency measures are understandable, but they are also an admission of a program's shortcomings. It would be far better for the state to accumulate reserves in prosperous years than to continue its current practice of hiking rates just as businesses are struggling to make payroll.

A well-structured unemployment compensation system prioritizes stability; by contrast, with its solvency tax layered atop a surtax, Wisconsin's system follows, rather than anticipates, the business cycle. Wisconsin's rates are high enough during an up economy; during a downturn, the even higher rates impose heavy burdens on the very businesses that are struggling to avoid layoffs. Policymakers would do well to rebalance rates, benefits, and structure to make the system more competitive.

<sup>148</sup> Jared Walczak, Scott Drenkard, and Joseph Bishop-Henchman, 2019 State Business Tax Climate Index, Tax Foundation, Sept. 28, 2018, Table 19.

<sup>149</sup> Wisconsin Department of Workforce Development, "Unemployment Insurance 2019 Tax Rates," accessed Nov. 26, 2018, https://dwd. wisconsin.gov/ui/employers/taxrates.htm.

# **Tax Triggers**

Tax triggers are a new take on an old concept: contingent enactment of a legislative provision. States have long relied upon bills with contingent enactment clauses, providing that certain features of new legislation shall only be operative if certain conditions are met. Tax triggers build on this model, making tax reform measures contingent on state revenues meeting or exceeding established targets.

Tax triggers can help ensure revenue stability and limit the uncertainty associated with changes to the tax code while providing an efficient way for states to dedicate some portion of revenue growth to tax relief. States are increasingly turning to tax triggers as a component of tax reform measures. <sup>150</sup> As noted in Chapter 5, Wisconsin has a small tax trigger, based on collections from its sales tax on remote sellers. Revenues will be used to lower individual income tax rates. The state also diverts "half of the difference between expected and annual revenue" to its rainy-day fund, a reasonable approach to ensuring that rainy-day balances are built up during periods of economic expansion to fund government services during economic downturns. 151

These two provisions are a small step in balancing the need for revenue availability with the need for tax reforms, but as these states that follow illustrate, the use of tax triggers can be quite robust. As policymakers in Wisconsin look to reform the state's tax code, tax triggers could be an essential element of that reform.

- Massachusetts voters in 2000 ratified a phase-in of tax cuts designed to reduce the state's individual income tax rate from 5.95 to 5.0 percent over three years, but the reductions were frozen by the legislature in 2002 at a rate of 5.3 percent. As a compromise, the legislature agreed to allow further reductions to a 5.0 percent rate to proceed, but only after a series of increases to the personal exemption had been implemented, and at a pace of 0.05 percent per year, contingent upon state tax revenues having grown at least 2.5 percent faster than the rate of inflation.
- Michigan, as part of a larger tax reform package enacted in 2015, is set to begin implementing income tax reductions in fiscal year 2023. Although several states have delayed implementation until several years after enactment, Michigan's eightyear deferral is unusual in its length. Following any year in which there is inflationadjusted general fund/general purpose revenue growth, the individual income tax rate is to be reduced by an amount calculated by an equation which captures a portion of cumulative inflation-adjusted revenue growth over fiscal year 2021 collections. The income tax rate would be reduced proportionately by the amount which the prior year's general fund revenue exceeded inflation-adjusted fiscal year 2021 revenue, multiplied by a statutorily set adjustment factor of 1.425 and divided by total income tax revenue. Competing legislation would have utilized year-overyear revenue growth rather than a cumulative measure of inflation to trigger tax cuts.

<sup>150</sup> Excerpted from Jared Walczak, "Designing Tax Triggers: Lessons from the States," Tax Foundation, Sept. 7, 2016, http://taxfoundation. org/article/designing-tax-triggers-lessons-states.

<sup>151</sup> The Pew Charitable Trusts, "Building State Rainy Day Funds," July 2014, 8, https://www.pewtrusts.org/~/media/assets/2014/07/ sfh\_rainy-day-fund-deposit-rules-report\_artready\_v9.pdf.

- North Carolina adopted comprehensive tax reform in 2013. That year's legislation saw substantial individual income, corporate income, and sales tax reform, along with the repeal of the estate tax, relying on triggers for some of the corporate income tax reductions. The 2013 legislation cut the corporate income tax rate from 6.9 percent to 6.0 percent while broadening the tax base by reducing certain tax credits and exemptions and scheduled a further reduction to 5.0 percent in 2014. Subsequent reductions, however, were made contingent on achieving statutorily-set revenue targets. Initially, the law established that if net general fund tax collections for the 2015 fiscal year exceeded \$20.2 billion, the tax rate would be reduced by one percentage point, with a similar provision in place should revenue exceed \$20.975 billion in fiscal year 2016. In 2015, after the first triggered reduction had been implemented, the General Assembly adopted further reforms, including an additional individual income tax rate reduction. Believing that these tax changes would delay reaching \$20.975 billion in revenue, the legislature removed the timeline, stipulating that the second triggered reduction would be implemented whenever net general fund revenues exceeded the benchmark figure, whether in fiscal year 2016 or thereafter. The adjustment notwithstanding, robust revenue growth has North Carolina on track to certify the 3.0 percent rate for the 2017 tax year.
- The **District of Columbia** in 2014 approved a tax reform package which reduced corporate and individual income tax rates, adopted more generous standard deductions and personal exemptions, and expanded the Earned Income Tax Credit, among other changes. Additional tax reform priorities were made contingent upon midyear annual revenue estimates exceeding preliminary annual revenue estimates, with any additional monies in fiscal years 2015 and 2016 funneled into implementation of as many as 17 tax reform provisions, addressed in order of priority.

Well-designed triggers ensure that benchmarks reflect meaningful revenue growth, rather than capturing a rebound from a year of weak revenues or the effects of inflation. They also avoid undue time constraints which can derail, rather than delay, the implementation of a program of contingent reforms. When properly constructed, tax triggers serve as a valuable mechanism for implementing responsible tax reform.