Five Options to Lower the Income Tax Rates in Wisconsin*

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Wisconsin has a progressive individual income tax system. The statutory marginal tax rate, which is the tax rate on the last dollar earned by a household, increases with household income. As shown in table 1, there are four taxable income brackets in 2022, where the marginal tax rate increases from 3.54% to 7.65%. The tax rate structure is cumulative, so that each tax rate applies only to income that falls within the corresponding bracket. A taxpayer with income exceeding the threshold for the top bracket would have income subject to each of the four tax rates.

Table 1: Wisconsin Individual Income Tax Rates and Brackets: 2022

	Taxable income brackets ($)		
Marginal tax rate (%)	Single	Married jointly	Married separately
3.54	Less than 12,760	Less than 17,010	Less than 8,510
4.65	12,760 to 25,520	17,010 to 34,030	8,510 to 17,010
5.30	25,520 to 280,950	34,030 to 374,600	17,010 to 187,300
7.65	280,950 or more	374,600 or more	187,300 or more

The marginal tax rates in Wisconsin are higher than the rates in most other states. The state's statutory rate for the bottom-income bracket is the 14th highest among all states and the District of Columbia, and its statutory rate for the top-income bracket is the 10th highest. The tax has become more progressive as well: The difference between the top and the bottom statutory rates has more than doubled since 2000.

There are at least three channels through which **the high and progressive income taxes have a negative impact on Wisconsin's economy**. First, high income tax rates cause out-migration, especially by high-skilled individuals and high-income households whose locations are more responsive to the income tax rates (Moretti and Wilson, 2017; Rauh, 2022). Due to interstate migration, Wisconsin's population dropped by 72,006 between 2010 and 2019, and it dropped again by 11,383 between 2020 and 2022. Partly because of this, Wisconsin's civilian labor force has declined by over 80,000 from its peak in July 2017, compared to an increase of over 6 million for the U.S. during the same period. Second, progressive taxation lowers worker productivity by reducing the incentive for human capital accumulation (Erosa and Koreshkova, 2007). Finally, because most pass-through businesses are paying the individual, as opposed to corporate, income tax, and pass-through income is highly concentrated among households in the top of the income distribution, the high and progressive income tax has a negative effect on firm investment and business formation. As a result, lowering tax rates has a significantly positive effect on output (Mertens and Ravn, 2013; Zidar, 2019).

We consider five options to lower Wisconsin's individual income tax rates. The first is a flat rate of 3.25% proposed in Senate Bill 1 of the 2023-2024 Wisconsin Legislature. The second option lowers the tax rates for the first two income brackets to 2%, and lowers the tax rates for the other two income brackets to 4.5%. The third option lowers the current tax rate for each income bracket by 1.5 percentage points. The four option is similar to the second one, but sets the top rate to 6.15% instead of 4.5%. To account for the 10% tax cut for low- and middle-income families proposed by Governor Evers in his 2023-2025 budget, the last option lowers the first three rates by 10%, while leaving the top rate unchanged at 7.65%.

Table 2: Five Options to Lower the Income Tax Rates in Wisconsin

	Marginal tax rate (%)				
Income bracket	Option 1	Option 2	Option 3	Option 4	Option 5
First (bottom)	3.25	2	2.04	2	3.186
Second	3.25	2	3.15	2	4.185
Third	3.25	4.5	3.8	4.5	4.77
Fourth (top)	3.25	4.5	6.15	6.15	7.65

There are many approaches to estimating the impact of the lower tax rates. One approach adopted by many government agencies, such as the Wisconsin Legislative Fiscal Bureau, is to apply both the current and the proposed tax rates to the same income data and use the difference as a measure of the impact of the proposed tax rates on taxes. By using the same income data, this approach ignores all behavioral responses mentioned above which are critical for evaluating the dynamic impact of lower tax rates on the state's economy.

We present a comprehensive model of the Wisconsin economy and its tax system to account for the behavioral responses from households and firms (Guo et al., 2023). We now use the model to evaluate the economic impact of the five options. In our model, income from pass-through businesses is subject to the top tax rate, a lower value of which raises the incentive for firms to invest. Earnings by the representative (median-income) household is subject to the second-highest rate, a lower value of which raises the incentive for the household to work and accumulative more skills. The increased economic activity leads to a larger tax base and partially offsets the loss of revenue from lower tax rates. Different from Guo et al. (2023), which focuses on the impacts of the top two rates, we now allow the bottom two rates to affect the tax level through the exemptions faced by the median-income household, so that lowering the bottom two rates raises the after-tax income and consumption.

Table 3 reports the impact of each option by comparing the steady state of the economy under the proposed tax rates with the steady state under the current tax rates. Measured in percentages, **the estimates represent the long-run effects accounting for behavioral responses**.

All five options increase capital, labor and output in Wisconsin. The increased economic

Table 3: Economic Impacts of the Five Options in Percentages (%)

	Option 1	Option 2	Option 3	Option 4	Option 5
			State aggregate		
Capital	5.49	2.85	2.42	1.67	0.38
Labor	3.80	1.67	1.8	1.105	0.38
Output	4.47	2.14	2.08	1.33	0.38
Wage rate	0.65	0.47	0.22	0.22	0.00
Corporate tax	2.79	0.96	1.51	0.77	0.38
Sales tax	4.29	2.44	2.26	1.71	0.43
Total tax	-14.55	-13.53	-12.78	-12.34	-3.54
			Median-income household		
Income tax	-27.73	-26.64	-30.05	-28.07	-9.43
After-tax income	5.08	2.93	2.86	2.15	0.61
Consumption	4.29	2.44	2.26	1.71	0.43

activity leads to more revenue for the state government from corporate taxes and sales taxes. The increased earnings from the higher wage rates and the extra labor also partially offset the loss of revenue from individual income taxes. Together, the loss of total revenue in the long run is significantly smaller than the loss in the short run. Without accounting for behavioral responses, the Legislative Fiscal Bureau (2023) estimated that the second option would reduce the state's revenue for tax year 2023 by about 23.5% ($5 billion), which is much larger than our estimate of 13.5% in the long run that accounts for behavioral responses by firms and households.

Quantitatively, as we move from the first to the last option, the impact on output decreases monotonically from 4.47% to 0.38%, and the loss of total tax revenue decreases monotonically from 14.55% to 3.54%. For the median-income household, the first four options would reduce the income tax by 26.64-30.05%, while the last option would reduce it by 9.43%. As we move from the first to the last option, the impact on after-tax income decreases monotonically from 5.08% to 0.61%, and the impact on consumption decreases monotonically from 4.29% to 0.43%.

The first four options also have a positive effect on the wage rate (per unit of worker skill) determined by the capital-labor ratio. Because the capital-labor ratio is chosen by firms who we assume are not affected by the first three income tax rates, the last option has no impact on the wage rate.

The impact on the wage rate is especially important for low-income households who pay zero tax and thus are not directly affected by the lower tax rates. Among the 3,143,440 filers for Wisconsin income tax in 2021, 26% had zero net tax. Even these households could benefit from the higher wage rates induced by the first four options.

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