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COMMENTS ON THE VALUE OF STATE TAX INCENTIVES

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I want to thank Marquette for its leadership in organizing this colloquium. I think this is an important discussion at an important time in the history of the state.

I served in the Department of Revenue from 1988 to 1996, and this morning when I was listening to our combined reporting discussion it was flash backs and *déjà vu* all over again. All these issues and arguments are very familiar, and I was struck by the notion of how resilient they are. I have been gone from the Department of Revenue for many years, but it seems like yesterday; nothing has really changed, and nothing has really been resolved. We have been talking about streamlined sales tax and combined reporting since the early 1990s. So it is true that these issues sustain themselves over the long haul of our state tax and fiscal policy discussions.

I appreciate the opportunity to talk about the value of tax incentives. I have fairly significant skepticism concerning the value of many of the tax incentives in both the Wisconsin and federal tax systems. My skepticism is based on a variety of factors, including how those incentives are granted to taxpayers, how they are paid for, how they are reviewed or benchmarked to determine their relative success in achieving their purposes, and finally their impact on tax administration in the Wisconsin Department of Revenue and the Internal Revenue Service.

We hear a lot about local governments, school districts, and others needing more money, and yet the state legislature and other policymakers continue to pursue the strategy of eroding the tax base at the same time that they are clamoring for more money. So there is a certain conflict in today's public dialog about the policies underlying tax incentives and tax spending generally. My sense is that the best tax policy is low rates and a broad base over which to apply our tax system.

The skepticism with regard to tax systems is warranted, in many ways, based on my experience over the years in state government. Many tax

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incentives grow out of political motivations that are not really grounded in what I would call good, solid tax policy. My experience with this whole issue of tax incentives suggests that policymakers and law makers, who propose incentives, do so for the wrong reasons. They do not take a meaningful look, doing what I would call due diligence. By due diligence, I mean a study of the probable impact of the roughly three hundred proposals that advance through the legislative process every year. We need to study the impact of these proposals, not only on the taxpayers they are trying to help, but also on the state's tax and fiscal system. This problem cries out, in my view, for an independent, "think tank" process. We need an independent data delivery system for policymakers, law makers, and others in this state, with respect to tax policy proposals. The point of this process would be to get an actual fix on the implications of the tax incentives that we talk a lot about in today's public policy venues.

My sense is that law makers do not understand the fiscal ramifications of many of the things that they propose. Indeed, my sense is that law makers and policymakers could care less (and this is based on personal experience, I must say) about the costs of administering a particular tax incentive, including the compliance costs associated with it. These are issues that just fall on deaf ears with regard to policymakers. They do not appreciate the implications in terms of an additional burden on the Department of Revenue, including the cost associated with adding staff to the Department, the paperwork associated with adding these complexities, and then the follow-up with respect to compliance to ensure that only those who are qualified take advantage of each of the incentives that is adopted. Policymakers do not appreciate, when they provide their sound bites and talk about the wonderful things they are doing with tax incentives, that the administrative burdens they have imposed can be enormous.

Policymakers rarely, in my view, analyze or benchmark the outcomes of these incentives. Has there been a meaningful look at whether the incentives we passed have accomplished the goals that were intended? Perhaps we do a good job of passing incentives, but we do not do a good job of following up to find out whether those incentives actually accomplish the goals that were discussed when the legislature agreed to them.

My sense is that most taxpayers, both corporate and individual, are driven by federal tax treatment. The state's tax policies, in relation to federal policies, are so minor in their impact, by and large, that any tax incentives that we provide on a statewide basis really pale in comparison to what corporate taxpayers or individual income taxpayers are paying attention to, which is their federal tax obligation. Policymakers do not comprehend that what we do on the state level is very small in relation to the totality of the tax picture for a particular corporation and, probably to a lesser degree, individual taxpayers as well. There is a strong argument that all the tinkering with incentives that we do at the state level is largely irrelevant when it comes to the overall tax burden on the corporation or the individual.

I believe the integrity of our tax system has been compromised and continues to be compromised every year. This includes, in my view, all state taxes, and certainly the individual income tax and the sales tax. We have made these taxes like Swiss cheese, chock full of holes, and as a result they are extremely unfair. Property taxes, as Ed Huck mentioned earlier, are a mess in many ways, and lawmakers and policymakers just have to come to grips with trying to undo what has been accomplished over the course of the last two or three decades.

We heard Secretary Morgan this morning talk about the principles of tax administration for the state, which I think were great: fairness, uniformity, equity, efficiency, and reliability. I think you can apply that to the current systems that we have and argue that none of those conditions currently applies to either the income tax, the sales tax, or the property tax. We have to reel back some of these changes that have been made and figure out a way to bring some sanity to our tax system.

Every time you narrow the tax base for any of these taxes, you increase the burden of taxation on others who are paying the tax. The uncertainty that comes with the approval and advocacy of these incentives is, unfortunately, common in fiscal policy and tax policy in Wisconsin.

It is very interesting to consider why legislators propose tax credits as opposed to granting some kind of direct state payment to produce a particular behavior. If you talk to most legislators, they will tell you that the reason that they do not propose direct appropriations to achieve a certain behavioral outcome is that it appears on the budget as an appropriation that has to be balanced and reconciled within Wisconsin's overall budget deliberations. A tax credit is not subject to the same requirement. While legislators may think that they are helping people by passing credits rather than making direct expenditures, what they are really doing is affecting the overall fiscal integrity of the state by circumventing the system of fiscal accountability.

I generally support the notion of direct expenditures to influence behavior, if that is what the state's policymakers want to do, and cleaning out the complicated tax credit systems. In my career in the Department of Revenue, one of my interesting jobs was to serve as a member of the Joint Committee on Tax Exemptions—a very important committee. In fact, it was chaired for many of the years that I was there by the new mayor of the City of Milwaukee, Tom Barrett. Every day that we met, and I think that we met every couple of weeks when the legislature was in session, a whole array of new tax exemptions would come before this Committee, for some of the most ridiculous things that you would never dream that people could cook up. Item after item came before us that some legislator was pushing in an effort to take some constituent out of the tax mix in one way or another. I do not recall a single time over the many years that we as a Committee met, a proposal to repeal a tax exemption. Proposals to repeal tax exemptions never came to the Committee for some reason. So, it is a troubling pattern.

Similarly, in the Department of Revenue, a great deal of time is spent meeting with people who are trying to figure out ways not to pay taxes through a variety of exemptions, incentives, or credits that the Department would like to see implemented to effectuate some behavior. So, my charge is to broaden the base and lower the impact on all taxpayers. I do not propose to raise taxes. Instead, we should make the tax system more fair by repealing all these preferences, thereby reducing the overall tax burden on the citizens that are actually paying the taxes here in the State of Wisconsin.

The tax system, as mentioned earlier, currently assumes a production-of-goods-based economy, and we are moving toward a more knowledge-based economy. We have to acknowledge that, look at the sales tax exemptions that are directly related to knowledge-based services, and figure out ways to incorporate that part of the economy into our tax mix as well.

One of the interesting questions that I think we have to ask ourselves is whether the behavior that we are trying to produce through tax incentives would occur were it not for the existence of these incentives. Would people continue to make charitable contributions if it were not for these incentives? I would say that they probably would. Would people continue to go to college were it not for these incentives? I would say they probably would continue to go to college. Would people continue to invest in historic buildings and refurbish historic buildings were it not for these incentives? I would say they probably would. Would people buy larger and more expensive homes were it not for the deduction of interest payments? I would say they would. In the case of corporations, to survive, would they continue to invest in research and development were it not for these tax incentives? My guess is they would, if they want to continue to survive.

One of the interesting aspects of tax incentives is the use of technology zones, enterprise zones, and development zones. I cannot even keep track of the number of zones—the whole state is a zone now of some kind or other. So we have created a patchwork of zones all over the place, where people are in duplicating and overlapping zones. Candidly, I have talked to some CFOs of corporations who say they have had a very difficult time figuring out the mishmash of tax policy, tax incentives, and initiatives that apply to their corporations in this state. All this complexity has been designed with the notion of providing tax initiatives to stimulate some kind of behavior. The bottom line, in my view, is that most of the behavior that tax incentives are designed to stimulate is going to happen anyway, and that is why I would argue for direct grants.

On the tax administration front, the Department of Revenue has enormous administrative burdens. The folks at DOR spend an incredible amount of time day in and day out administering, or overcoming confusion and complexity associated with, changes in state tax laws. Our policymakers say that they want to simplify the tax system, but they seem to do the complete opposite. So the administrators of DOR are stuck with the clean-up brigade; cleaning up after the circus parade is the way that I used to think of it. They are left trying to figure out all of the ramifications of these incentives and deductions and credits, and they must deal with corporations and other taxpayers who make mistakes because they simply cannot find their way through the morass of our current tax system.

My call would be for tax reform. I think it is necessary. We have a unique time now with a new leadership team. We have some challenges with school finance. We have other fiscal challenges within the state. But it seems to me that the time is right to really look at the entirety of the state's tax system and figure out ways to remove unnecessary, irrelevant, and redundant tax incentives. It is also time to figure out ways to broaden the tax base and lower the overall tax burden for all the citizens in the State of Wisconsin.

We have 107 high-tech research- and science-based companies that are currently populating University Research Park. When the policymakers in the state talk about tax relief, to these companies it means little. Most of these companies, which in my view are the future of this state, do not earn any income on which to claim credit or incentives. What they are really interested in is a healthy and vibrant economy and, when they do pay taxes, a low tax burden for all of them. So I think if we made a commitment, a leadership commitment, a statesman-like commitment to try and clean up the clutter of our system, reduce the overall burden, and spread the burden much more broadly throughout society—and that is true for all taxes—we would have a much cleaner, better, and more efficient system consistent with the DOR goals and objectives.

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