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THE VULNERABILITY OF USING TAX INCENTIVES IN WISCONSIN

BY VADA WATERS LINDSEY*

I. INTRODUCTION

The United States has gone through constant turmoil during the early years of the millennium. The country has had to contend with financial instability resulting from an unstable stock market, high unemployment and war. The United States continues to lose employers and jobs to foreign countries after the enactment of the North American Free Trade Agreement. More than three million jobs have been lost in the United States during the last three years. Since March 2001, manufacturing jobs accounted for 90% of all job losses. Many jobs were lost to China, India, and Mexico. The State of Wisconsin has not begun the millennium unscathed. The unemployment level is high, and businesses are relocating from and downsizing in Wisconsin at an alarming rate. The major newspaper in Milwaukee regularly includes news stories reporting the loss of jobs and the relocation of corporate headquarters. During November 2003, the Milwaukee paper reported that since October 2000, Wisconsin had lost 84,000 jobs or 14% of its workforce. In January 2004, Rayovac Corporation, a corporation

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1. While the North American Free Trade Agreement has had negative impact, the United States had valid reasons for entering into the agreement. According to Duke political science professor Frederick W. Mayer, the United States agreed to negotiate the free trade agreement for three reasons: Mexican stability was important, increased trade with Mexico would be beneficial, and a regional agreement was necessary to counter the European Union. See FREDERICK W. MAYER, INTERPRETING NAFTA (1998) (cited in Andrea Kupfer Schneider, Book Review, Getting to NAFTA: A Review of Interpreting NAFTA by Frederick W. Mayer, 17 BERKELEY J. INT'L L. 330, 334 (1999)).


4. Id.

5. Joel Dresang, Unemployment Rate Down: Unemployment Rate Down, but Manufacturing Suffering, MILW. J. SENTINEL, Nov. 21, 2003, at 6D.
founded in Madison in 1906, announced that it would relocate its corporate headquarters from Madison, Wisconsin to Atlanta, Georgia. Wisconsin also lost several additional major headquarters, including Kimberly-Clark, CNH Global, and Fort Howard Corporation.

While much of the corporate downsizing and relocation can be attributed to the general downturn in the United States economy as a whole, there are several areas of the country that continue to have an influx of new businesses and employment growth. In Lee County, Florida, for the fiscal year ending June 2003, there was job growth by 9000 jobs or 4.6% because several businesses located there. The strong Lee County job growth was attributable to the low cost of conducting business, low housing costs, and the "absence of an income tax." The job base in Texas has expanded in the technology industry, and there has been an influx of corporate headquarters to metropolitan Dallas. The job base in Clark County, Nevada increased by 26,500 because its health care industry attracted the influx of pharmaceutical and research companies.

Of primary concern in this Article is the extent to which the State of Wisconsin should utilize tax incentives to encourage businesses to relocate and remain in Wisconsin. This Article will also explore the significance of Wisconsin's maintaining an environment that promotes education. While it is essential that Wisconsin retain a strong business base, that objective is dependent on the presence of an educated and employable population. This Article addresses whether it is more appropriate to promote both business growth and education under direct expenditures programs.

This author has extolled the virtues of the federal government's use of tax incentives to promote desired behavior. While Wisconsin generally follows much of the federal law, it has decoupled from Congress's recent

7. Id.
8. During the last three years, the United States has lost over two million jobs. Chaker, supra note 2, at D1.
9. Id.
10. Id.
12. Id.
enhancement of some important tax incentives intended to spur the economy. There are valid revenue constraints that states must consider in their decision to decouple. Therefore, Wisconsin must be somewhat cautious in attempting to attract and retain businesses and in subsidizing education. This Article will explore the extent to which Wisconsin should promote both education and business by enacting tax incentives or whether additional constraints discourage their use and effectiveness at the state level to promote business growth and education. Part II of this Article will examine the approach Wisconsin uses in encouraging education. This part deals primarily with the primary and secondary levels. This part will also examine Wisconsin's "Milwaukee Parental Choice Program" and "Chapter 220 Program." Part II also compares the Wisconsin approach to encourage education with the tax incentive approach utilized in several states.

Part III of this Article explores Wisconsin's use of tax incentives and direct expenditures to enhance business growth and stability. This part will also examine the problems that Wisconsin has encountered in its attempt to promote business growth. One of the major issues addressed is the constitutional barriers associated with the Commerce and Equal Protection Clauses. This Article will outline the constitutional barriers that hinder the adoption of particular state tax incentives. Finally, Part III of this Article will consider additional barriers to the use of tax incentives as devices of strengthening the local economy through business growth.

II. THE PROMOTION OF EDUCATION IN WISCONSIN

A. Promotion of Education Through Tax Incentives or Direct Expenditures

The economy has been generally weak during the last few years; however, job opportunities are increasingly available for qualified workers in the areas of health care, education, finance, and real estate. Education is an integral component of establishing a strong base of employable and competent workers in these industries as well as other industries. The National Association of Colleges and Employers ("NACE") forecasts a 12.7% increase in college graduate hires in the country, the first increase since 2001. Generally, college graduates earn higher wages than employees who lack a collegiate education. In a recent study conducted by the Wisconsin Policy

15. Jane J. Kim, Graduates' Rosy Outlook Has Thorns, WALL ST. J., Mar. 18, 2004, at 3D.
16. During 2001, the median income for workers possessing a Bachelor's degree was $49,985, while the median income for high-school graduates was only $28,343. INCOME 2001, U.S. CENSUS BUREAU, at http://www.census.gov/hhes/income/income01/inctab7.html. Moreover, the median
Research Institute ("WPRI"), it was determined that Milwaukee, Wisconsin's largest city, has gone from being one of the nation's strongest economically to one of the weakest. The study made the following observations:

Per capita income has fallen to 44th among the largest 50 cities.

[E]conomic success strongly correlates to educational accomplishments, and... Milwaukee is far behind other cities on that score. In 2000, they say, 18% of residents had college degrees, compared with an average of 27% among the 50 largest cities. They urge the city to increase the number of college graduates 5300 a year through 2020 to reach the average.

Milwaukee's heritage as a blue-collar, working-class city is now working against economic growth.... Today's successful cities have a smaller blue-collar population and a higher proportion of their residents with college degrees and creative abilities.

If the WPRI study and NACE forecasts are accurate, Wisconsin must increase the number of college graduates in Milwaukee. The percentage of Wisconsin residents possessing at least a Bachelor's degree is below the national average as well. During 2000, 22.4% of Wisconsin's population possessed at least a Bachelor's degree, whereas the national average was 24.4%. To the extent that Wisconsin can subsidize education, the question arises whether direct expenditures are a more effective means of subsidizing education or whether tax incentives are more effective. Congress subsidizes education under the Internal Revenue Code by granting credits, and allowing a deduction for student loan interest. Therefore, the Federal

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18. Id. (quotations omitted).
20. Id.
23. See IRC § 221 (2004) (allowing a deduction for up to $2500 for interest paid on students loans for lower to middle income taxpayers). Of course, Congress also makes direct expenditures in support of education.
government uses tax incentives to promote education. In order to advance Wisconsin’s economic stability, the state needs to continue to provide financial support from kindergarten through the collegiate level. Although Wisconsin furthers education by use of tax incentives to encourage education, it relies primarily on direct expenditures to promote education and is one of the leaders in its establishment of school vouchers or school choice and promotes school integration under the “Chapter 220” program.

The Wisconsin Legislature enacted the “Milwaukee Parental Choice Program” as a mechanism of promoting education under a direct expenditure format. Under a choice program, school vouchers may be used to offset the tuition or related fees of a participating school of choice. Under the choice program, any Milwaukee student from grade kindergarten through twelve is subsidized in attending any private school located in Milwaukee if all requirements are satisfied, including a requirement that the total family income cannot exceed 175% of the poverty level. The Milwaukee choice program caps the maximum percentage of district students who are allowed to participate in the program at 15%. During the 2003-04 academic year, the maximum voucher was $5882 per student. As of the official attendance date for the current academic year, the total number of students in the Milwaukee Parental Choice Program was 13,419, and these students were enrolled in 106 Milwaukee private schools. The 14-year Milwaukee choice program is the largest choice program in the country and costs the state approximately $75 million annually.

In addition to the choice program, the Wisconsin Legislature enacted the Chapter 220 program during 1975 in order to promote voluntary cultural and

24. For example, Wisconsin provides a deduction up to $3000 for contributions to Wisconsin’s section 529 state program.

25. The Supreme Court upheld the validity of Cleveland’s school choice programs against an Establishment Clause attack, holding that there was no violation where the parents have the opportunity to choose between religious and nonreligious schools. See Zelman v. Simmons-Harris, 536 U.S. 639 (2002). See also Frank R. Kemerer, State Constitutions and School Vouchers, 120 Ed. L. Rep. 1 (1997) (presenting a detailed review of constitutional provisions of each state in addressing the likely outcome of litigation in state courts).

26. WIS. STAT. ANN. § 119.23 (West 2004). The Wisconsin Supreme Court has also upheld the constitutionality of the Milwaukee Parental Choice Program. See Jackson v. Benson, 218 Wis. 2d 835, 578 N.W.2d 602 (1998).

27. WIS. STAT. ANN. § 119.23(2)(a)(1) (West 2004).

28. WIS. STAT. ANN. § 119.23(2)(b) (West 2004).

29. Sarah Carr & Alan J. Borsuk, Committee Votes to Lift Enrollment Cap for Milwaukee School Choice, MILW. J. SENTINEL, Oct. 16, 2003, at 1B.

30. Id.

Under the Chapter 220 program, if a "minority group pupil" resides in a school district where at least 30% of the pupils enrolled in the school that the pupil would attend are also minority group pupils, the pupil is able to attend a school in another school district where members of that group constitute less than 30% of the students enrolled at the selected school. At its peak in 1993, there were 6503 participants in the Chapter 220 program; however, the participation has generally declined each year and during academic year 2002-03, there were only 4846 participants in the program. According to a report issued by the Public Policy Forum, the state paid $47 million to Milwaukee Public Schools and the 23 participating suburban districts during the 2000-01 academic year under the Chapter 220 program.

Other states have rejected the direct expenditure approach and adopted tuition tax credits to encourage education. Florida allows for corporate tax credits for donations to a tuition scholarship fund, and Pennsylvania allows for corporate tax credits for donations to nonprofit organizations that provide scholarships. Arizona, Illinois, and Minnesota have enacted individual tax...
TAX INCENTIVES IN WISCONSIN

credits for certain educational expenses.\textsuperscript{39}

B. Problems Associated with Using Tax Incentives to Encourage Education

Some proponents support the use of tax credits to subsidize and promote education. One argument in support of tax credits is that the use of school tax credits will broaden competition in schools because tax credits will empower parents to penalize schools that are performing below par and force them to become more competitive or fail.\textsuperscript{40} Proponents also argue that the grant of school tax credits is an appropriate mechanism of relieving "double taxation" for parents paying private school tuition and funding public schools through property taxes.\textsuperscript{41}

The United States Supreme Court upheld a state’s allowance of tax deductions for education expenses more than 20 years ago.\textsuperscript{42} However, the enactment of tax incentives in the form of either tax credits or tax deductions cannot overcome undeniable policy constraints. One classic argument against the use of tax incentives to encourage education is that it violates vertical and horizontal equity.\textsuperscript{43} Horizontal equity is breached because similarly situated taxpayers are not taxed similarly.\textsuperscript{44} Taxpayers with similar income are not taxed similarly if one taxpayer is eligible for the tax incentive but another taxpayer is ineligible to receive the credit. Vertical equity is premised on the notion that higher income taxpayers should bear a larger burden of the tax liability based on an ability to pay concept.\textsuperscript{45} Where deductions or tax incentives favor the wealthy, vertical equity is weakened. For example, if lower income taxpayers do not have sufficient income to make a tax credit beneficial, but the higher income taxpayers are able to claim the credit, vertical equity is implicated.

To the extent that state legislatures enact educational tax credits, the credits should resemble Minnesota's statutory provision. Under Minnesota's tax scheme, the credit begins to phase out for taxpayers with income greater


39. See id.


41. See Robinson, supra note 38, at 253-54 (citations omitted).


43. See Robinson, supra note 38, at 258.

44. In reference to the Hope credit, the Joint Committee on Taxation stated that the credit violated horizontal equity, but equity should be relegated to a secondary consideration when social goals are being addressed. See Robinson, supra note 38, at 258 (citing Staff of Joint Econ. Comm., 105th Cong., The Administration's Proposal for a Tuition Credit 4 (Comm. Print 1997)).

45. Wisconsin implements vertical equity under its Constitution, which states that income taxes may be imposed and those taxes may be graduated and progressive. Wis. Const. art. VIII, § 1.
than $33,500 and is completely phased out for taxpayers with income exceeding $37,500. The Minnesota provision solves two problems. The phase-out of the credit beginning at $33,500 is consistent with the principles of vertical equity. In addition, the credit is refundable; therefore, even if a taxpayer lacks sufficient tax liability to absorb the credit, the tax commissioner will refund any excess to the taxpayer.

A second constraint of using tax incentives to encourage education arises even if the credit is refundable and vertically phases out. A tax incentive is useless for lower income taxpayers because they invariably lack the requisite resources to make educational expenditures for private school tuition and other eligible educational expenditures. Consequently, the most significant hurdle in the enactment of state tax credits to promote education is that many lower to middle income taxpayers lack the immediate resources to permit them to defray the ultimate costs associated with education-related expenses. In such a case, vertical equity is violated because higher income taxpayers are able to claim the credit, but in many cases lower income taxpayers are unable to utilize the credit because they either lack tax liabilities or the immediate resources needed to pay the education expenses.

Wisconsin’s use of direct expenditure under its Milwaukee Parental Choice Program and Chapter 220 Program does not result in the foregoing equity constraints. However, Wisconsin’s approach is not lacking in controversy, particularly the voucher program. Consistent with public schools in other major metropolitan cities, many of the Milwaukee public schools have innumerable problems. One argument against the use of state taxpayer dollars to defray private tuition expenses is that money should be used to offset budgetary constraints in the public schools rather than merely benefiting a few students attending private schools. Some scholars oppose the use of increasingly limited public dollars that had traditionally been used to fund public schools to indirectly benefit private institutions. State taxpayer dollars are used to defray tuition expenses for a small percentage of primary and secondary students. The voucher program does not adequately address the compelling need for Milwaukee to maximize educational opportunities for a larger percentage of its residents to reverse the downward economic spiral resulting from its dismal number of college graduates as compared to the national average.

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46. MINN. STAT. ANN. § 290.0674 (West 2003).
47. MINN. STAT. ANN. § 290.0674(2)(b) (West 2003).
In addition, opponents urge the dismantling of the choice program because of inadequate regulatory control over the participating schools. Recently, the Wisconsin Legislature took steps to assuage some of these concerns by enacting new regulatory rules and making the participating private schools more accountable. Under the new rules, the private school must submit an independent financial audit to the State Department of Public Instruction. In addition, a participating school must provide a copy of its current certificate of occupancy, evidence of financial viability, and proof that the school administrator had participated in a fiscal management training program. Finally, the state superintendent may bar a private school from participating in the program if it fails to comply with these provisions or presents "an imminent threat to the health or safety of pupils." The Department of Public Instruction exercised its authority under these newly created rules to bar two problematic schools from further participation in the choice program.

The Milwaukee Parental Choice Program and the Chapter 220 Program have not reversed the disturbing educational disparities between the races. While Wisconsin had an impressive statewide high school graduation rate of 91.8%, the graduation rate for Blacks or African-Americans was a woeful 62.9%. Another compelling statistic that exemplifies the disparity between African-American students and other students in the state is the ACT college entrance exam ranking. For the seventh year in a row, Wisconsin's average composite score of 22.2 was the highest among states where at least 40% of high school students took the test. Conversely, the average composite score for African-American students was 17.1, much lower than the Wisconsin state average. Most of Wisconsin's African-American students reside in Milwaukee. As a result, based on the below-par ACT composite scores and graduation rate for African-Americans, there is a strong argument that Wisconsin's approach to educating African-Americans, including the choice and Chapter 220 programs, is unsuccessful. However, the programs do, in fact, provide participants choices of alternative educational placement that might not have otherwise existed. Moreover, some of the problems that exist

54. Amy Hetzner, Teacher Data Shows Discrepancy; State has more who are 'Highly Qualified' than are Fully Licensed, MILW. J. SENTINEL, Mar. 12, 2004, at 1B.
55. Sarah Carr, State Earns Highest ACT Scores; Wisconsin has Ranked in Top Spot for 7 Consecutive Years, MILW. J. SENTINEL, Aug. 20, 2003, at 3B.
56. Id.
in Milwaukee's education system are the result of sociological and cultural issues, involving poverty, teen pregnancy, and drugs. Consequently, until those issues are resolved, Milwaukee will have difficulty reversing the negative empirical data, whether it relies on tax incentives or direct expenditures.

In comparing the two direct expenditure approaches employed in Wisconsin, the Chapter 220 program represents a better use of the state's tax dollars. First, the tax dollars are not being diverted from public schools to private schools. Second, there is no threat of an Establishment Clause challenge. Third, the Chapter 220 Program's objective of integration is becoming more important as the general population become more diverse. Finally, the state is able to exert more regulatory control over the public schools than private schools because of the constitutional limitations.

III. WISCONSIN'S USE OF BUSINESS TAX INCENTIVES

A. In General

The starting point for determining a Wisconsin taxpayer's tax liability is the taxpayer's federal adjusted gross income. Wisconsin diverges in many respects from the federal law; consequently, Wisconsin requires certain additions and subtractions from the federal adjusted gross income to account for these differences. Several of these differences are based on Wisconsin's decision to decouple from many tax incentives that are incorporated in the Internal Revenue Code. The United States Congress routinely enacts tax incentives to encourage desired behavior. Many of these tax incentives are intended to spur the economy. While the use of tax incentives complicates the Internal Revenue Code, Congress continues to rely on them in conjunction with its use of direct expenditures. For example, under the Jobs and Growth Tax Reconciliation Act of 2003, Congress made substantial changes to section 179, which allows for a current deduction for the purchase of tangible personal property. Under the Act, Congress temporarily increased the deduction from a maximum deduction of $25,000 to $100,000. The section 179 deduction is phased out to the extent that the tangible personal property acquired during the taxable year exceeds a threshold amount. Under the Act, Congress increased the phase-out threshold from $200,000 to $400,000. Finally, Congress included off-the-counter software as qualifying property. While Wisconsin allows the section 179 deduction, Wisconsin declined to

adopt the 2003 Congressional changes that maximized the tax incentive.\textsuperscript{58} Wisconsin’s decision to decouple its treatment of section 179 from the federal law saved the state a substantial amount of lost revenue.

Wisconsin also declined to adopt the IRC § 168 special depreciation rules that Congress enacted under both the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Reconciliation Act of 2003. In order to “promote capital investment, modernization, and growth” and “spur an economic recovery,” Congress enacted an additional first-year depreciation deduction of 30\% of the depreciable basis for qualified property acquired after September 10, 2001 under the Job Creation and Worker Assistance Act of 2002.\textsuperscript{59} For property acquired after May 5, 2003, Congress enacted an additional first-year depreciation deduction of 50\% under the Jobs and Growth Tax Reconciliation Act of 2003.\textsuperscript{60} The State of Wisconsin decoupled its depreciation system from the 30\% and 50\% federal bonus depreciation amounts.

Similar to the section 179 election, Wisconsin’s decision to decouple from the federal government’s bonus depreciation reduced the prospect of a revenue shortfall. While the revenue impact on Wisconsin is unclear, the Center on Budget and Policy Properties estimated that state revenues would be reduced by $14.1 billion during the years that the 30\% additional depreciation were applicable if all states conformed to the federal law.\textsuperscript{61} Conversely, an argument against Wisconsin’s decoupling from the amendments to the section 179 election and the section 168 bonus depreciation would be that taxpayers would invest in more tangible personal property used in the trade or business and depreciable property, resulting in expansion of business operations and increased revenue stream for the state. Hence, based on this line of reasoning, the statutory changes would result in a tax break for business owners, but the additional revenue resulting from the business growth would offset its cost.

While Wisconsin decoupled from the Congress’s latest round of tax savings, Wisconsin does rely on tax incentives to subsidize business activities. The primary question to be considered herein is whether tax incentives add value in Wisconsin or whether the state should rely primarily on direct

\textsuperscript{58} See News for Tax Practitioners, at http://www.dor.state.wi.us/taxpro/news.html.

\textsuperscript{59} Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 107th Congress 218 (CCH 2003).

\textsuperscript{60} If a taxpayer claims the 50\% additional depreciation for qualified property, the taxpayer is not able to claim the 30\% additional depreciation for the same property. Jobs and Growth Tax Relief Reconciliation Act of 2003, Conference Report 18–19 (CCH 2003).

\textsuperscript{61} Breaking Up is Hard to Do: States Respond to Federal Bonus Depreciation, at http://www.taxadmin.org/fta/rate/decoupling/tan_art.html.
expenditures to further economic growth, stability, and employment. The previous section considered whether tax incentives should be employed in Wisconsin to further education. This section addresses whether Wisconsin should adopt tax policies to compete with other states in persuading businesses to locate some operations in Wisconsin or in encouraging existing business operations to remain in the state.

B. The Role of Incentives in Attracting and Retaining Businesses in Wisconsin

States routinely compete with other states in encouraging businesses to locate to and remain in their states. One of the earliest uses of tax incentives to induce a business to relocate to a particular state occurred during 1791 in persuading Alexander Hamilton to locate his manufacturing plant in New Jersey. Since that time, the amount of state money devoted to that endeavor has skyrocketed. It is estimated that states spend approximately $30 billion per year in competing for businesses. The competition is not merely to encourage businesses to relocate to the state but also to remain in the state. Some of the frequently used tax incentives are tax credits, depreciation, and property tax exemptions. For example, during the 1990s, Cytec Industries, Inc., received $19 million in local property tax abatements from Louisiana during a 10-year period. The nontax incentives include cash grants, free or discounted real property, employee training and relocation assistance, and infrastructure improvements. Consistent with other states, Wisconsin has sacrificed tax revenue to subsidize business activities. Wisconsin exempts from property taxes machinery and equipment used in manufacturing. During 2001, approximately $12.5 billion of the equipment was exempted from taxation. Under certain circumstances, Wisconsin also exempts manufacturing machinery and equipment from sales and use tax, resulting in a reduction of such taxes of approximately $240 million for Fiscal Year 2000.

67. Walgren, supra note 66, at 11.
In order to encourage corporate research and development, Wisconsin follows the federal law and grants a nonrefundable credit for certain research conducted in the state, resulting in $32 million of tax credits for 1999. As Wisconsin attempts to forge a recovery from the recent recession, it is inevitable that Wisconsin will continue relying on tax incentives to promote business growth and stability. The following section will examine the problems Wisconsin faces as it competes for businesses and strives for economic stability.

C. Problems Associated with the Use of Tax Incentives

1. Constitutional Barriers

Every tax scheme must be sustained against constitutional attacks based on the Commerce and Equal Protection Clauses. While the courts have adjusted their analyses over the years, Wisconsin tax schemes have been subjected to constitutional attacks for generations. As will be discussed, there is an equal protection component to the Commerce Clause analysis because the statute must not discriminate against interstate commerce. Wisconsin tax measures must also withstand equal protection attacks independent of the Commerce Clause. The constitutionality of a statutory provision is a question of law, and the Supreme Court of Wisconsin has long held that where a tax measure is at issue, there is a strong presumption of constitutionality.

a. Equal Protection Attacks

A state tax measure will be considered valid under an equal protection analysis unless there are apparent gross misclassifications. The standard that

68. Walgren, supra note 66, at 3.
69. See, e.g., U.S. Glue Co. v. Town of Oak Creek, 247 U.S. 321 (1918) (holding that assessment under Wisconsin general income tax upon Wisconsin corporation was not a sufficient burden on interstate commerce to affect an unconstitutional interference); State ex rel. Borden Co. v. Dammann, 198 Wis. 265, 224 N.W. 139 (1929) (striking down a statute that required the payment of a tax on authorized capital stock for violating the Equal Protection and Commerce Clauses); State v. Whitcom, 122 Wis. 110, 99 N.W. 468 (1904) (addressing whether statute that exempted some businesses and individuals from licensing fee was a tax or an exercise of the police power and whether it was a violation of equal protection of the laws).
70. GTE Sprint Communications Co. v. Wis. Bell, Inc., 155 Wis. 2d 184, 192, 454 N.W.2d 797, 800 (1990).
71. See Simanco, Inc. v. Wis. Dep’t of Revenue, 57 Wis. 2d 47, 54, 203 N.W.2d 648, 651 (1973).
72. Id. at 55, 203 N.W.2d at 652. According to the Supreme Court of Wisconsin, “a legislature has much more leeway in granting exemptions in taxation measures than it does in regulatory measures under its police power without running athwart of equal protection of the laws clause of the
the Supreme Court of Wisconsin applies in determining the constitutionality of tax measures under an equal protection analysis is whether the "classification is arbitrary and has no reasonable purpose or relationship to the facts or a justifiable and proper state policy." The states have broad power to make classifications in the areas of economic and fiscal regulation in order to achieve reasonable state policies. The burden of proof is on the party challenging the legislative enactment. The Equal Protection Clause of the Wisconsin Constitution is substantially equivalent to the United States Constitution; therefore, courts construe the Wisconsin Constitution as affording the same protections as those under the United States Constitution. In Simanco, Inc. v. Wisconsin Department of Revenue, the Supreme Court of Wisconsin addressed the constitutionality of an amendment to section 71.337(1) of the Wisconsin Statutes. That section permitted nonrecognition of gain or loss to liquidating corporations resulting from the sale or exchange of their property. Section 71.337(1) was enacted to comport with Internal Revenue Code § 337. Section 337 of the Internal Revenue Code permits nonrecognition treatment to a liquidating corporation for property distributed to a parent corporation. Congress enacted section 337 to prevent double taxation. The nonrecognition provision under Wisconsin law was made inapplicable to the extent that nonresidents participated in the distribution of assets because the risk of double taxation would not exist. The state would lose substantial revenue resulting from its inability to tax the corporation, as well as the nonresident shareholder, upon the redemption of their stock.

In Simanco, a corporation argued that the classification under the Wisconsin statute was unconstitutional because it violated the Equal Protection Clause of the United States Constitution. The court concluded that the classification did not violate the Equal Protection Clause because the

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Fourteenth Amendment." Id. (citing Hillside Transit Co. v. Larson, 265 Wis. 568, 583, 62 N.W.2d 722, 730 (1954)).

73. Simanco, 57 Wis. 2d at 57, 203 N.W.2d at 653 (citations omitted).

74. Id. at 54–57, 203 N.W.2d at 652–53 (citations omitted).

75. Just v. Marinette Co., 56 Wis. 2d 7, 201 N.W.2d 761 (1972) (cited in Simanco, 57 Wis. 2d at 54, 203 N.W.2d at 651).

76. GTE Sprint Communications Co. v. Wis. Bell, Inc., 155 Wis. 2d 184, 193, 454 N.W.2d 797, 801 (1990).

77. 57 Wis. 2d 47, 203 N.W.2d 648 (1973).

78. Section 71.337(1) was subsequently repealed and replaced by section 71.23.

79. Simanco, Inc. v. Wis. Dep't of Revenue, 57 Wis. 2d 47, 51, 203 N.W.2d 648, 650 (1973).

80. Id.

81. Id. at 51–53, 203 N.W.2d at 650–51.

82. Although the Supreme Court of Wisconsin held that section 71.337(1) did not violate the Equal Protection Clause, the court of appeals concluded that it violated the Privileges and Immunities Clause in certain circumstances. See Polan v. Dep't of Revenue, 147 Wis. 2d 648, 433 N.W.2d 640.
classification was neither arbitrary nor capricious.\textsuperscript{83} If all shareholders were Wisconsin residents, Wisconsin would be able to tax the gain realized by the shareholders. To the extent that the shareholders were all nonresidents, the State of Wisconsin would be unable to tax the corporation without the statutory classification nor would the state be able to tax any of the shareholders on gain realized. The state had valid reasons for enacting the classification in order to achieve reasonable economic and fiscal state policies.\textsuperscript{84}

Conversely, the Supreme Court of Wisconsin concluded that a state retail sales tax that the state imposed upon the transfer of local access telephone services of interexchange telecommunications, but not of local exchange carriers and transfers of access services to resellers, was unconstitutional under the Equal Protection Clause.\textsuperscript{85} The Wisconsin Legislature enacted section 77.51(m) to offset anticipated revenue shortfalls resulting from a Department of Revenue ruling that exempted interexchange carriers, local exchange carriers, and resellers from the payment of taxes for the purchase of access services.\textsuperscript{86} According to the court, the imposition of the tax only upon the interexchange carriers was arbitrary and unconstitutional under the Equal Protection Clause. Unlike the Supreme Court of Wisconsin in \textit{Simanco}, the court in \textit{GTE Sprint Communications} did not find any substantial distinction between the different categories of carriers. In \textit{Simanco}, there existed a rational basis for disparate treatment; however, no such basis existed in \textit{GTE Sprint Communications}. As indicated by the court in \textit{Simanco}, the loss of revenue represents a valid purpose for a tax. However, in \textit{GTE Sprint Communications}, the court concluded that there was no valid reason why the

\textsuperscript{(Ct. App. 1988). In \textit{Polan}, the court concluded that section 71.337(1) violated the Privileges and Immunities Clause of the U.S. Constitution because of the state’s discriminatory treatment of nonresidents where the shareholders sustained a loss, the only shareholders were nonresidents, and the corporation had a loss. \textit{Id.} at 661–62, 433 N.W.2d at 645–46.\textsuperscript{83} \textit{Id.} at 653, 433 N.W.2d at 642.\textsuperscript{84} The Wisconsin Supreme Court has found other classifications to be valid under the Equal Protection Clause. See, e.g., \textit{Midcontinent Broadcasting Co. v. Dep’t of Revenue}, 98 Wis. 2d 379, 297 N.W.2d 191 (1980) (upholding the imposition of sales tax where taxpayer held a sales permit because administrative convenience was a sufficient justification to an equal protection attack); \textit{Moebius Printing Co. v. Wis. Dep’t of Revenue}, 89 Wis. 2d 610, 279 N.W.2d 213 (1979) (rejecting commercial printer’s claim that the imposition of the sales tax on printed material, combined with the exclusion of the use tax on materials retained in the state for subsequent use solely outside the state gave businesses the incentive to purchase outside of the state); \textit{Hillside Transit Co. v. Larson}, 265 Wis. 568, 62 N.W.2d 722 (1954) (finding equal protection challenge to exemptions to a ton-mile tax constitutional because the legislature is authorized to use exemptions to help certain industries economically).\textsuperscript{85} \textit{GTE Sprint Communications Co. v. Wis. Bell, Inc.}, 155 Wis. 2d 184, 189–91, 454 N.W.2d 797, 799 (1990).\textsuperscript{86} \textit{Id.} at 195, 454 N.W.2d at 802.
tax should be imposed on some purchases but not others.

b. Commerce Clause Violations

Under the dormant Commerce Clause of the United States Constitution, a state taxing statute will be invalidated if it burdens interstate commerce and therefore interferes with Congress’s authority to regulate commerce among the states. The United States Supreme Court set forth a four-part test in determining whether a tax violates the dormant Commerce Clause. A tax will be upheld if it is applied to an activity with a “substantial nexus” to the taxing state, is fairly apportioned, relates to the services provided by the taxing state, and does not discriminate against interstate commerce. The purpose of state taxation on interstate commerce is to ensure that the interstate commerce contributes “a fair share of the cost of the local government whose protection it enjoys.”

A Wisconsin circuit court recently addressed whether a tax exemption

87. Midcontinent Broadcasting Co. of Wis., Inc. v. Dep’t of Revenue, 98 Wis. 2d 379, 394, 297 N.W.2d 191, 199 (1980).

88. See Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977) (cited in Northwest Airlines, Inc. v. Wis. Dep’t of Revenue, No. 02-CV-3533 (CCH) ¶ 400–731 (Wis. Cir. Ct. Nov. 7, 2003)). This Article addresses only the discrimination prong of the commerce clause analysis. There are countless Wisconsin cases that address the other prongs. See, e.g., Am. Trucking Ass’n, Inc. v. State, 205 Wis. 2d 494, 556 N.W.2d 761 (Ct. App. 1996) (holding that hazardous materials transportation fee invalid under the commerce clause because it violated the apportionment prong of the standard); United Parcel Service Co. v. Wis. Dep’t of Revenue, 204 Wis. 2d 63, 73, 553 N.W.2d 861, 865 (Ct. App. 1996) (finding an apportionment formula is unconstitutional when it is established by “‘clear and cogent evidence’ that the income attributed to the state is in fact ‘out of all appropriate proportion to the business transacted in that state’ or has ‘led to a grossly distorted result’”); Am. Tel. Co. v. Wis. Dep’t of Revenue, 143 Wis. 2d 533, 422 N.W.2d 629 (Ct. App. 1988) (concluding that apportionment formula applied to interstate public utility violated due process and commerce clauses because it did not bear a reasonable relationship to the utility’s in-state activities); Nat’l Liberty Life Ins. Co. v. State, 62 Wis. 2d 347, 369, 215 N.W.2d 26, 37 (1974) (finding general revenue tax imposed on out-of-state mail order insurer found unconstitutional because it was an unapportioned tax); Moore Motor Freight Lines, Inc. v. Wis. Dep’t of Taxation, 14 Wis. 2d 377, 111 N.W.2d 148 (1961) (stating that fairly apportioned taxes do not unduly burden the commerce clause). Other jurisdictions apply similar constitutional analysis in determining whether a tax violates the commerce clause. See, e.g., Simon Aviation, Inc. v. Indiana Dep’t of State Revenue, 805 N.E.2d 920, 929 (Ind. 2004) (holding that Indiana’s use tax placed a greater burden on aircraft purchased out-of-state than aircraft purchased in-state and impermissibly discriminated against interstate commerce); Bulkmatic Transp. Co. v. Dep’t of State Revenue, 715 N.E.2d 26 (Ind. 1999) (holding that special tax exemption for fuel had an effect of making it cheaper to operate certain in Indiana than out-of-state and therefore violated the interstate commerce because it was discriminatory); Scholastic Book Clubs, Inc. v. State, 567 N.W.2d 692 (Mich. Ct. App. 1997) (concluding that Michigan’s imposition of use tax against out-of-state company for its use of Michigan teachers to take book orders from taxpayer’s catalogs violated commerce clause because of insufficient nexus).

from both ad valorem and property taxes for air carriers operating hub facilities in Wisconsin violated the Commerce Clause.\textsuperscript{90} Air carriers that did not operate hub facilities in Wisconsin were subject to an ad valorem tax in lieu of a property tax. Northwest Airlines challenged the constitutionality of the exemption on several bases, including interstate commerce and equal protection grounds.\textsuperscript{91} The basis of the interstate commerce claim was that the exemption discriminated against interstate commerce. While it is not unconstitutional for a state to tax dissimilar businesses differently, the state cannot tax similar businesses dissimilarly. Businesses are not dissimilar for purposes of the analysis based solely on the amount of business conducted in Wisconsin.\textsuperscript{92} Moreover, under the statutory provision, the airline had to maintain its company headquarters in Wisconsin in order to qualify for the exemption. The circuit court found that the provision “patently violate[d]” the commerce clause because the business would clearly be disadvantaged if it chose to maintain its corporate headquarters outside of the State of Wisconsin.\textsuperscript{93} The Wisconsin Department of Revenue appealed the adverse decision.

The recent invalidation of Wisconsin’s tax incentives favoring air carriers operating hub facilities was not the first occasion that tax incentives targeted at in-state businesses had been determined to violate the Commerce Clause. For example, in Beatrice Cheese, Inc. v. Wisconsin Department of Revenue,\textsuperscript{94} the Wisconsin Tax Appeals Commission invalidated section 71.04(15)(b) of the Wisconsin Statutes, an accelerated depreciation provision restricted to in-state facilities, because it discriminated against interstate commerce.\textsuperscript{95}

Similarly, in Burlington Northern, Inc. v. City of Superior,\textsuperscript{96} the Wisconsin Legislature had imposed an occupational tax equal to 5% per ton of all iron ore concentrates handled by and over docks.\textsuperscript{97} The tax was imposed on operators of iron ore concentrate docks, but the statutory scheme

\textsuperscript{90} Northwest Airlines, Inc. v. Wis. Dep’t of Revenue, No. 02-CV-3533 (CCH) ¶ 400–731 (Wis. Cir. Ct. Nov. 7, 2003).
\textsuperscript{91} During 2000 through 2002, the plaintiff, Northwest Airlines, paid approximately $1.5 million on an ad valorem basis each year. Conversely, although Midwest Express paid approximately $1.95 million in ad valorem taxes during 2000, the airline did not have any taxes due during 2001 and 2002 resulting from the statutory exemption. \textit{Id}.
\textsuperscript{92} \textit{Id}.
\textsuperscript{93} \textit{Id}.
\textsuperscript{94} Nos. 91-1-100-102, 1993 WL 57202, at 3 (cited in Peter D. Enrich, \textit{Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business}, 110 \textit{Harv. L. Rev.} 377, 437 (1996)).
\textsuperscript{95} \textit{Id}.
\textsuperscript{96} 131 Wis. 2d 564, 388 N.W.2d 916 (1986).
\textsuperscript{97} \textit{Id} at 570, 388 N.W.2d at 919.
exempted iron ore concentrates mined in Wisconsin and handled over the docks. During the period from 1977 to 1980, iron ore concentrates mined in Minnesota by various steel producers passed through Burlington Northern's docks in the city of Superior and were loaded on barges to be carried to various ports and steel mills located outside of Wisconsin. The Supreme Court of Wisconsin noted that a state tax was not "per se invalid" simply because it burdened interstate commerce, but a state was unauthorized to indiscriminately tax conduct that constituted interstate commerce. The Supreme Court of Wisconsin held that the state tax was unconstitutional under the Commerce Clause because the statute provided a commercial advantage to local businesses at the expense of out-of-state miners. According to the court, the fact that the legislature intended to aid in-state mining rather than to hamper out-of-state miners was not a relevant criterion because the determination was based on either discriminatory effect or purpose. Consequently, Wisconsin must exercise great care in promoting Wisconsin businesses while not infringing on interstate commerce.

2. Political Fallout

The State of Wisconsin is one of the most heavily taxed states in the country. One of the reasons that Wisconsin's tax burden is traditionally higher than other states is that the state and local governments rely more heavily on taxes rather than fees. As documented by Professor Andrew Reschovsky, when comparing Wisconsin with other states, Wisconsin ranks above the average state in tax levies but below average on fees and charges, such as automobile registration and public recreation fees. For 2002, more than one-third of state and local tax revenue is derived from property taxes, and the state's property tax revenue is above the national average. Most of the property tax revenue is derived from residential property. Most of the state tax revenue is from sales and individual income taxes. For example, during 2003, sales taxes constituted 30.7% and individual income taxes

98. Id. at 571, 388 N.W.2d at 919–20.
99. Id. at 575, 388 N.W.2d at 921.
100. Id. at 576, 388 N.W.2d at 921.
101. Id. at 578, 388 N.W.2d at 923–24.
104. Although the data is unavailable for fiscal year 2003, for fiscal year 2002, 68.8% of the total property taxes involved residential property, defined as single-family and multifamily housing with no more than eight units. WIS. DEP'T OF REV., DIV. OF RESEARCH & POL'Y, State and Local Taxes in Wisconsin 5 (2002), at http://www.dor.state.wi.us/ra/proptx02.pdf.
constituted 43.1% of state taxes.105 Conversely, the corporate income tax for 2003 accounted for only 4.3% of the total state taxes collected during the year.106 The corporate income taxes collected by all 50 states ranged from zero to 20.2%, and the average corporate tax was 5.2%.107 Wisconsin's corporate tax was only slightly below the average; however, a different result occurred when comparing the individual income tax. Wisconsin ranked eighth when compared to the total tax revenue collected under the individual income taxation.108

There are several conceivable justifications for the relatively low percentage of corporate tax in relation to other forms of revenue. According to Wisconsin Department of Revenue estimates, while there are approximately 107,000 Wisconsin corporations, 51,000 of them are subchapter S corporations, pass-thru entities not subject to double-taxation.109 Hence, almost 50% of Wisconsin corporations are not subject to tax at the corporate level, and all items of income are taxed at only the investor level. Other forms of business, including sole proprietorships, limited liability companies, and partnerships, tax income at the investor level only. Consequently, some of the individual income tax is attributable to business income. The reality, however, is that other states also tax income derived from subchapter S corporations, partnerships, limited liability companies, and sole proprietorships only at the investor level, but Wisconsin still ranks below other states in the percentage of its total tax revenue that is derived from the corporate tax.

The empirical data establishes that the percentage of revenue attributable to state individual taxes in Wisconsin exceeds the national average, but the revenue attributable to corporate income taxes is below par. For this reason, Wisconsin is not in the position to rely on additional tax incentives that could exacerbate the disparity. Politically, it would be difficult to justify corporate tax breaks while the percentage of revenue collected from individuals is above the national figures and the percentage collected from corporations is below average. Moreover, any decrease in the corporate income taxes would necessitate an increase in some other taxes.

During 2003, there were four states that did not have corporate income taxes.2003 State & Local Taxes by Source, at http://www.taxadmin.org/fta/rate/03taxdis.html. 105

Id. 106

Id. 107

Id. 108

taxes, but they also did not impose individual income taxes. In all four jurisdictions that lacked both individual and corporate taxes, their percentage of revenue derived from the general sales tax was generally greater than the average of all states. Conversely, Wisconsin's revenue collected from the general sales tax was generally lower than the national average. If Wisconsin lowered the tax on businesses by enacting additional tax incentives, it is probable that some other tax would be increased, such as the general sales tax, to account for revenue shortfalls. An increase in the general sales tax would necessarily result in increased regressivity. Low- to middle-income residents spend a larger portion of their income on consumables and are unable to invest much money in capital investments. On the other hand, higher income individuals are able to invest a higher percentage of their income in long-term investments and spend a lower percentage on consumables. An increase in fees and other charges would have the same result.

This conclusion is not altered by the fact that Wisconsin's use of tax incentives to promote business growth would subsidize other forms of business. The use of tax incentives to spur business development would lower the tax liabilities of incorporated and unincorporated businesses. The obvious impact of the business tax incentives would be to lower the tax liability of the more affluent Wisconsin taxpayers. If this reduction resulted in an influx or retention of business operations in Wisconsin without an increase in other taxes and fees, it would be an effective use of tax policy. However, if the business tax incentives do not increase tax revenue by spurring the economy, the lowered business tax revenue would need to be offset by increased taxes or fees and, in all probability, increased regressively.

3. Ineffective Long-Term Benefits of Location Incentives

Many academics do not believe that tax incentives induce businesses to locate in a particular state. Professor Richard Pomp is a well-known proponent of supporting the elimination of states' use of tax incentives to lure businesses to their states. Professor Pomp outlined 10 reasons why state tax

110. These states are Nevada, Texas, Washington, and Wyoming. See id.
111. See id.
112. See id.
113. Matthew T. Furton, The Use of Penalty Clauses in Location Incentive Agreements, 70 IND. L.J. 1009, 1015 (1995) (citations omitted). But see Andrew L. Kolesar, Note, Can State and Local Tax Incentives and Other Contributions Stimulate Economic Development?, 44 TAX LAW. 285, 292 (1990) (stating that "tax policy and tax incentives may affect the location decision because direct taxes on businesses lower the rate of return on that investment").
114. Richard D. Pomp, The Role of State Tax Incentives in Attracting and Retaining Business:
incentives were an ineffective means of stimulating business and attracting businesses to locate to a state.\textsuperscript{115} The factors that are particularly compelling are: 1) other costs associated with business operations greatly exceed state and local taxes; 2) state and local taxes are deductible at the federal level thereby reducing the after-tax impact of state tax incentives; 3) the value of tax incentives, such as property tax abatements, may be reduced by lower property values in the state;\textsuperscript{116} and 4) state and local taxes fund services important to businesses, including education and improved infrastructure.\textsuperscript{117}

Another significant problem that states have encountered is their inability to prevent businesses from relocating after benefiting from both direct and tax incentives. For example, during 1992 the city of Ypsilanti, Michigan, unsuccessfully attempted to enjoin General Motors from closing an assembly plant after it had received $13.5 million in property tax abatements.\textsuperscript{118} There is a substantial amount of empirical data establishing that states lose revenue when they use location incentives because the businesses relocate from the state before any long-term benefits can be realized. A state’s use of location incentives to remain competitive with other states can actually jeopardize the state’s economic stability. Legal scholars refer to this course of action as the “race to the bottom.”\textsuperscript{119}

Finally, Wisconsin’s use of tax incentives represents a costly and ineffective method of encouraging businesses to relocate and remain in the state. It would be difficult for Wisconsin to recoup location incentives because state businesses might relocate to other states before any return on its investment could be materialized. Therefore, Wisconsin should be leery about relying too heavily on tax incentives to spur economic development. This is particularly true where Wisconsin utilizes tax incentives because,
unlike direct incentives, the true cost is often concealed.

IV. CONCLUSION

Wisconsin needs to continue attracting and retaining business ventures in the state. It must also work diligently to promote education from elementary school through the collegiate level. Both of these objectives are instrumental to maintaining economic stability. While Wisconsin utilizes tax incentives to encourage education under its section 529 program, its voucher program—a direct expenditure program—is one of the leading choice programs in the country. The program has its flaws, but it does not pose the numerous problems that exist under a tax incentives program. The state also promotes educational integration under the Chapter 220 program by providing state funds to encourage schools to desegregate. To gauge the success of the Milwaukee Parental Choice Program and Chapter 220 program, studies need to be conducted to objectively evaluate the programs’ effectiveness. Empirical data need to be compiled following objective criteria: high school graduation rates of participants in the programs, composite ACT and SAT entrance exam scores, and college graduation rates.120

With respect to business growth, the federal government’s use of tax incentives does not pose the numerous problems that result when the states rely too heavily on them to spur the economy by granting tax incentives. There is no guarantee that tax incentives are nothing more than a windfall to the intended beneficiaries. There is support for the argument that businesses are more concerned with issues such as infrastructure and schools. There are constitutional constraints that might invalidate the tax incentive. The amount of loss in revenue is difficult to project when the state uses tax incentives to encourage businesses to relocate or remain in the state as compared to direct expenditures. There are no guarantees that the state is able to recoup the lost revenue if the business subsequently relocates to another state. Finally, any reduction of business taxes will result in an increase of some other form of taxation, such as the sales tax. The consequence of an increase in the general sales tax is a corresponding increase in regressivity.

120. It is important for the empirical data to be thorough and objective. A recent study conducted by a conservative think tank concluded that the graduation rate of students graduating from private high schools under the voucher program was significantly higher than the overall graduation rate of students attending Milwaukee Public Schools. Alan J. Borsuk, Graduation Rates Under Choice Higher, Study Says, MILW. J. SENTINEL, Sept. 30, 2004, at 1B. However, the sample included only 10 private high schools receiving funding under the voucher program. In order to assess the success of the program, all students participating in the voucher program must be compared with those attending the Milwaukee Public Schools.