WISCONSIN BUDGET PROJECT

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Will Recent Changes to Capital Gains Tax Be Rolled Back?

As policymakers contemplate how to create jobs in Wisconsin and how to finance state services and local aid, they might want to take a look at A Capital Idea: Repealing State Tax Breaks for Capital Gains Would Ease Budget Woes and Improve Tax Fairness, a new report issued by the Institute on Taxation and Economic Policy (ITEP).

The report makes a convincing case that tax breaks for income derived from capital gains decrease revenue at a time when the state already has a significant shortfall, disproportionately benefit the very best-off taxpayers, and do little or nothing to promote economic growth.

Until recently, Wisconsin had the most generous provision in the nation for exclusion of capital gains income from state income tax, with 60 percent of net income gained from selling assets exempt from state income taxes. In 2009 the exclusion was cut in half to 30 percent.

According to the report, Wisconsin is one of only eight states with substantial capital gains tax breaks. Nationally, those provisions together reduced taxes by an estimated $490 million in 2010. In Wisconsin, the tax break for capital gains was $151 million, or 31 percent of the national total. To put this amount in perspective, this represents more General Purpose Revenue than Wisconsin spends each year on the technical college system.

Most of the benefit of the capital gains exclusion accrues to the wealthiest taxpayers, which means other taxpayers have to pick up the tab for the cut. According to the ITEP report, special treatment for capital gains income resulted in an average tax reduction for the bottom 80% of taxpayers of a whopping $4, compared to nearly $4,000 for the top 1%.

Can tax breaks for capital gains income help create jobs? The report cites a slew of experts to the contrary, from the Congressional Budget Office to Mark Zandi of Moody's.com, and sums up by declaring, "preferential treatment for capital gains is simply not an effective means of promoting economic growth."

Nevertheless, on the campaign path Governor Walker advocated rolling back the 2009 changes to the capital gains tax. In a speech today at the Wisconsin Bankers Association, Walker said he would be in favor of eliminating the capital gains tax altogether for investments made in Wisconsin. However, Walker has not yet made any specific proposals regarding the capital gains tax.

Senator Hopper is circulating a bill that would go even further because it isn't limited to investments in Wisconsin. He believes that taxing capital gains "hampers investment dedicated to job creation and reduces economic growth." His proposal returns the capital gains exclusion to 60 percent in tax year 2012 and phases in a full exclusion over the following two years, creating an 80% exclusion in 2013 and a full 100% exclusion in 2014 and beyond.

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