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POLICY BRIEF

Treat Profits from Investments the Same as Income from Work
Instead of Giving Preferential Treatment to Investment Profits

For tax purposes, Wisconsin should treat profits from investments the same as income from work. Currently, Wisconsin gives preferential treatment to profits from investments, which results in tax breaks for the best off. Most other states treat profits from investment the same as income from work.

Tax Breaks for Investment Income

When capital assets, such as stocks, bond, or real estate, are sold, the profit is called "capital gains." Wisconsin excludes 30% of these capital gains from taxation, and then taxes the remaining 70% as ordinary income.

The top marginal income tax rate paid on income from work is 7.75% in Wisconsin. Because 30% of capital gains are excluded from taxation, the top rate for income from capital gains is essentially 5.425%.

This difference in how Wisconsin treats income from capital gains and income from work means that people with similar amounts of income sometimes pay very different amounts of income tax.

Wisconsin is one of just eight states that give substantial tax breaks for capital gains income compared to income earned from working.

Tax Break Mostly Benefits Wealthiest

Most of the benefit of Wisconsin's capital gains exclusion goes to the wealthiest taxpayers, which means other taxpayers have to pick up the tab for the cut.

Wisconsin taxpayers with adjusted gross incomes of $200,000 or more received 46% of the benefit of breaks on capital gains income in 2009, despite making up less than two percent of all tax returns.

Taxpayers with adjusted gross incomes of more than $1 million made up just 0.1% of total returns, yet received more than one out of every five dollars of the total capital gains tax break. The average amount of capital gains excluded from taxation for people with incomes over $1 million was $246,000 in 2009.

The bottom 67 percent of taxpayers – those with adjusted gross income under $50,000 – got only 15 percent of the benefit of the preferential treatment for capital gains.

A Significant Price Tag

Wisconsin's current policy of excluding 30% of capital gains from taxation means that $882 million of capital gains income was not taxed in 2009.

The 2011-13 budget included new tax breaks for people with capital gains that are from Wisconsin investments or reinvested in Wisconsin. In the 2013-15 budget period, the cost of those new tax breaks will be $51 million, and that amount will grow in subsequent years as the tax breaks are fully phased in. These more targeted capital gains tax breaks significantly reduce the arguments for maintaining the broad 30 percent exclusion.

Capital Gains and Business Climate

Would treating all income the same hurt Wisconsin's business climate? Given that most states already tax income from capital gains the same as income from work, and the tenuous nature of the connection between capital gains taxation and economic growth, the answer is no.

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