State Income Tax Reciprocity and the Minnesota Study

Federation of Tax Administrators
Revenue Estimating & Tax Research Conference
October 8, 2013
Springfield, Illinois

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St. Paul Pioneer Press

September 26, 2013

Still no tax reciprocity for border crossers

Minnesota, Wisconsin can't agree; 80,000 interstate workers affected; deadline Tuesday

The longstanding Minnesota-Wisconsin reciprocity agreement was ended effective with tax year 2010.

Income Tax Reciprocity

What is Tax Reciprocity?

- Agreement to exempt the earned income of residents who live in a neighboring state from income tax.
- Viewed as a convenience for taxpayers and simplification for tax filings.
- Only pay income tax to the state where you are a resident, not to the state where you work.

Income Tax Reciprocity

What is covered?

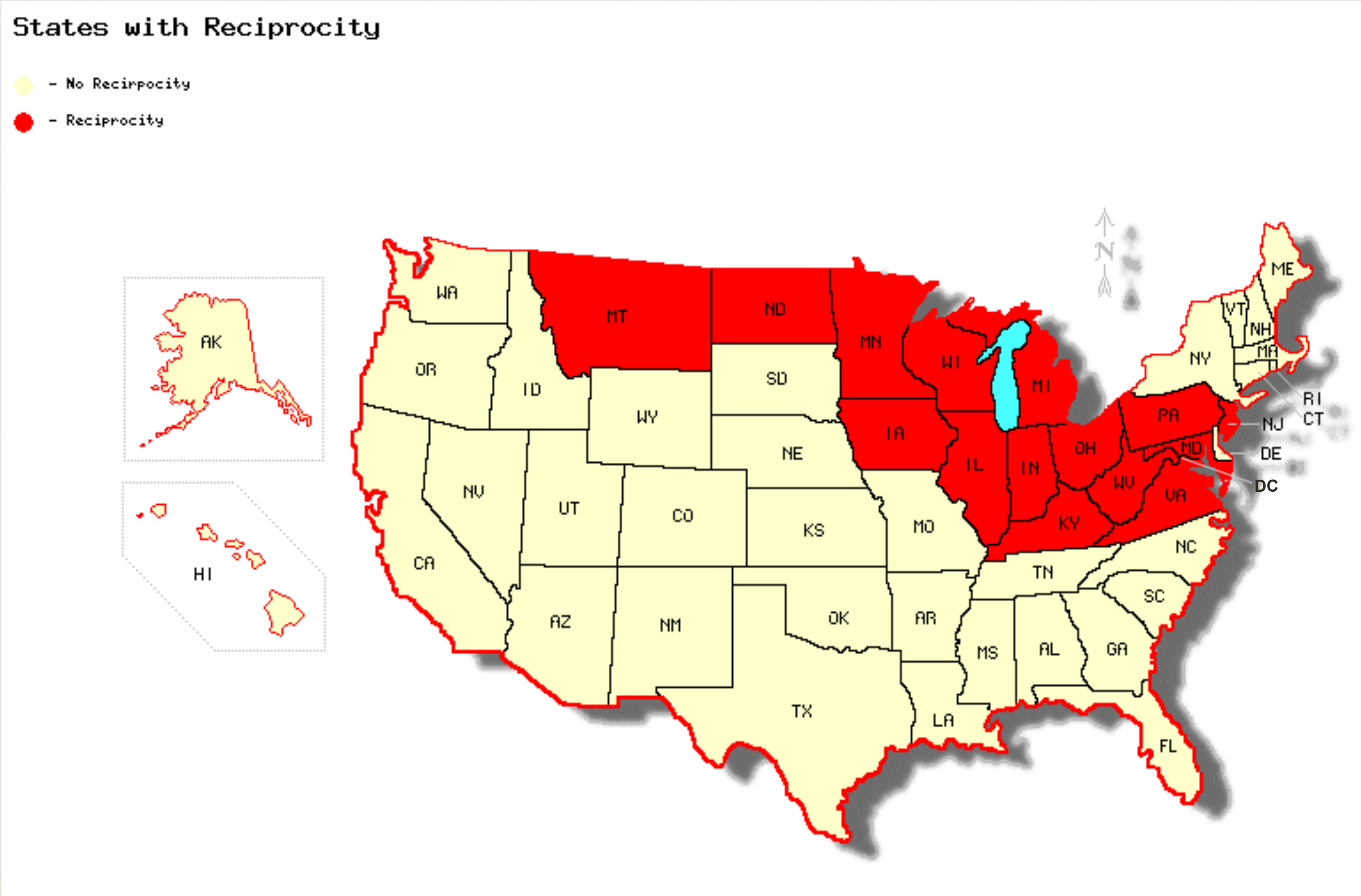
- Generally only covers personal service income such as wages, tips, and commissions that are earned in a state.
- Does not apply to interest income, capital gains, or other income sources not earned through employment.

Income Tax Reciprocity

Reciprocity makes a difference for income tax filing requirements and what is paid:

- Will describe and illustrate some of the tax impacts resulting from reciprocity.
- Will summarize the background and results of Minnesota's Income Tax Reciprocity Benchmark Study.
- Other information for cross-border workers.

Income Tax Reciprocity



Income Tax Reciprocity

List of States with Reciprocity

If you work in…	**And you are a resident of…**
District of Columbia	anywhere other than the District of Columbia
Illinois	Iowa, Kentucky, Michigan, or Wisconsin
Indiana	Kentucky, Michigan, Ohio, Pennsylvania, or Wisconsin
Iowa	Illinois
Kentucky	Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia, or Wisconsin
Maryland	District of Columbia, Pennsylvania, Virginia, or West Virginia
Michigan	Illinois, Indiana, Kentucky, Minnesota, Ohio, or Wisconsin
Minnesota	Michigan or North Dakota
Montana	North Dakota

Income Tax Reciprocity

List of States with Reciprocity (Cont.)

If you work in…	**And you are a resident of…**
New Jersey	Pennsylvania
North Dakota	Minnesota or Montana
Ohio	Indiana, Kentucky, Michigan, Pennsylvania, or West Virginia
Pennsylvania	Indiana, Maryland, New Jersey, Ohio, Virginia, or West Virginia
Virginia	District of Columbia, Kentucky, Maryland, Pennsylvania, or West Virginia
West Virginia	Kentucky, Maryland, Ohio, Pennsylvania, or Virginia
Wisconsin	Illinois, Indiana, Kentucky, or Michigan

Impact of Reciprocity on Taxpayers

Reciprocity is an *exception* to how personal service income is generally taxed.

General rule for residents:

- Income is subject to tax in the state of residence.
- Nonrefundable credit is allowed for tax paid to another state on the same income.

General rule for nonresidents:

- Wage and personal service income is taxed in the state where earned.

Impact of Reciprocity on Taxpayers

- ***With reciprocity***, the taxpayer files a return and pays the tax only in the state where they live.
- ***Without reciprocity***, taxpayers who work in another state file two returns and pay tax in both states AND pay the equivalent of the higher of the tax of the state of employment or the state of residence.

Impact of Reciprocity on Taxpayers

Overall impact on taxpayers under reciprocity:

- Some taxpayers pay the same amount of total tax as compared to the two states.
- Some taxpayers pay less in total tax than to the two states.
- No one will pay more.

Impact of Reciprocity on Taxpayers

Minnesota Resident Working in Wisconsin	Without Reciprocity	With Reciprocity
Wisconsin tax	$2,000	$0
Minnesota tax	$1,750	$1,750
Credit for tax paid to Wisconsin	$1,750	$0
Minnesota tax after credit	$0	$1,750
Total tax for both states	$2,000	$1,750
Wisconsin Resident Working in Minnesota	**Without Reciprocity**	**With Reciprocity**
Minnesota tax	$1,750	$0
Wisconsin tax	$2,000	$2,000
Credit for tax paid to Minnesota	$1,750	$0
Wisconsin tax after credit	$250	$2,000
Total tax for both states	$2,000	$2,000

Impact of Reciprocity on Taxpayers

- For taxpayers with losses:
  - ***With reciprocity***, would have reduced liability due to loss and filing only in state of residence.
  - ***Without reciprocity***, depending on the state, taxpayers can pay tax on the entire income earned in the state of employment, with no offsetting reduction for the loss.
- Treatment differs among states.

Impact of Reciprocity on Taxpayers

Minnesota-Wisconsin Comparison of 2010 Individual Income Tax Burdens for Married-Joint and Single Filers

Income	Married-Joint Filers			Single Filers		
	Minnesota	Wisconsin	Difference	Minnesota	Wisconsin	Difference
$20,000	($1,260)	($173)	$1,087	$547	$475	($72)
$35,000	($524)	$236	$760	$1,367	$1,506	$139
$50,000	$1,188	$1,514	$326	$2,346	$2,529	$183
$75,000	$2,628	$2,970	$342	$3,579	$3,621	$42
$100,000	$4,039	$4,495	$456	$5,286	$5,210	($76)
$150,000	$6,927	$7,266	$339	$9,054	$8,355	($699)
$250,000	$13,268	$13,019	($249)	$15,335	$13,977	($1,358)

Source: "Comparison of Individual Income Tax Burdens by State," Minnesota Center for Fiscal Excellence, March 2013

Impact of Reciprocity on Tax Revenues

- ***Without reciprocity***, taxpayers file in both states and pay in total the higher of the tax in the two states.
- ***With reciprocity***, states have reduced revenues as some taxpayers pay less.
- Main reason for reduced revenues is the application and limits for tax credits.
- E.g., the credit for tax paid to other states is generally limited to lesser of tax paid to state of employment or tax in the state of residence on the same income.

Impact of Reciprocity on Tax Revenues

- If reimbursement provisions applicable, revenue can be impacted due to timing of payment provisions.
- Example is prior Minnesota-Wisconsin agreement with payment made for net revenue loss on December 1 following the tax year.
- Lag shifted revenue to later fiscal years (Minnesota realized substantial one-time revenue gain when reciprocity ended).

Background of Minnesota-Wisconsin Agreement

- Had agreement for tax years 1968 through 2009.
- Reimbursement provision added beginning with tax year 1973 with payment due December 1 of following year (averaged 17 months later than withholding).
- Interest was included in payments for tax years 2001 through 2009.
- Agreement ended beginning tax year 2010 after no agreement reached to accelerate and modify payments.

Study Methodology

- Both Minnesota and Wisconsin conducted a study of their 2011 returns.
- Questions as they appeared on Minnesota Form M1.

Wisconsin Residents Working in Minnesota:
Was any of your income from personal or professional services performed in Minnesota while a Wisconsin resident? No ☐ Yes ☐ If yes, enter Minnesota income: __________

Minnesota Residents Working in Wisconsin:
Was any of your income from personal or professional services performed in Wisconsin while a Minnesota resident? No ☐ Yes ☐ If yes, enter Wisconsin income: __________

Study Methodology

- For reciprocity income in Minnesota, in addition to wage, salaries, etc., self-employment income is also included.
- Personal service income includes income earned as an employee, independent contractor, self-employed person or partner, as long as you personally performed the service in the other state.
- It can also be net income from federal Schedule C or a share from a partnership on Schedule E.

Study Methodology

- Needed to capture additional information from schedules M1-NR (Nonresidents/Part-Year Residents) and M1CR (Credit for Income Tax Paid to Another State) for paper returns during processing and the study.
- Needed to review and verify return information to determine reciprocity income, particularly for self-employment income.
- W-2 data from both states was used.
- Tax calculator computer programs written to determine impact from reciprocity.

Minnesota Reciprocity Study Results

Wisconsin Residents:

- 55,743 Minnesota returns filed by Wisconsin residents who worked in Minnesota.
- $2.434 billion personal service income on those returns.
- 45,290 returns with Minnesota tax liability on personal service income.
- $104.1 million loss of Minnesota tax.

Minnesota Reciprocity Study Results

Minnesota Residents:

- 23,940 Minnesota returns filed by Minnesota residents who worked in Wisconsin.
- $718 million personal service income on those returns.
- 18,224 returns claimed a credit for tax paid to Wisconsin on personal service income.
- $30.4 million gain from not providing this credit.

Minnesota Net Revenue Loss

- $73.7 million ($104.1 million tax loss minus $30.4 million gain from credit).

Minnesota Reciprocity Study Results

Final combined results of both Minnesota and Wisconsin studies:

- Net impact of reciprocity on both states revenues is loss of $6.4 million.
- Equals difference of Minnesota loss of $73.7 million and Wisconsin gain of $67.3 million.

Minnesota Reciprocity Study Results

Final combined results of both Minnesota and Wisconsin studies: (Cont.)

- Difference mainly because tax credit for tax paid to the other state cannot exceed the tax for the state of residence.
- Minnesota and Wisconsin have an ongoing disagreement over the calculation method for the payment regarding the difference.

Other Information on Cross-Border Workers

- Difficult to know effects of reciprocity directly from tax return information.
- One source of publicly available data for cross-border workers is Census Bureau's American Community Survey.

Other Information on Cross-Border Workers

American Community Survey (ACS) Information:

- Includes place of residence, place of work, wage and salary income...
- Place of residence definition is based on living quarters, where expected length of stay in household is two months or more.
- Exception is for those who maintain two residences for commuting purposes (considered a resident of the residence not close to the workplace).

Other Information on Cross-Border Workers

- ACS can be used to produce information for cross-border workers:
  - Can summarize wages and salaries for cross-border workers by income level.
  - Can compare differences in average incomes and income flows between states.

Any Other Studies?

- Is There a Connection Between Reciprocity and Tax Competition? (Rork and Wagner, 2012)

The authors find that not only do reciprocity agreements allow states to have higher income tax rates than do nonreciprocity states, but also that the states with reciprocity agreements have increased levels of competition over other taxes.

Any Other Studies?

- Income Taxes and the Destination of Movers to Multistate MSAs (Coomes and Hoyt, 2007)

The authors find that differences in state income tax rates have an impact on the rate of migration to states within multistate metropolitan areas (MSAs). However, they found that the effect of tax disparities was only statistically significant for non-reciprocity states, as compared to reciprocity states. One reason given is that only large differences in state income tax rates impact migration, and these differences are more pronounced in MSAs without reciprocity.

Summary

Overall impacts from reciprocity:

- Tax filing requirements (one return instead of two) and state administration.
- Income tax liabilities (some taxpayers pay less tax).
- Affects total state income tax revenues.

[Income Tax Reciprocity Benchmark Study (March 2013)]()

Reciprocity between Minnesota and Wisconsin

www.revenue.state.mn.us/research_stats/research_reports/2013/reciprocity_study_report_march_2013.pdf