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Minnesota Income Tax Reciprocity Agreement
(General Fund Taxes -- Income and Franchise Taxes)

CURRENT LAW

Under state law, residents of other states who receive income from the performance of personal services in Wisconsin are subject to taxation under Wisconsin's individual income tax. However, such income is exempt from Wisconsin taxation if the other state taxes that income and if the other state agrees not to tax income received for the performance of personal services in that state by Wisconsin residents. The Secretary of the Department of Revenue (DOR) enters into those agreements on behalf of Wisconsin. In addition, state law authorizes the DOR Secretary to enter agreements with the states of Minnesota and Illinois that include compensatory payments if the income tax revenue foregone by one of the states exceeds the income tax revenue foregone by the other state.

GOVERNOR

No change to current law.

DISCUSSION POINTS

1. Wisconsin currently has income tax reciprocity agreements with four states: Illinois, Indiana, Kentucky, and Michigan. In addition, Wisconsin had a reciprocity agreement with Minnesota for tax years 1968 through 2009. Like Wisconsin's current agreement with Illinois, the reciprocity agreement with Minnesota required a compensation payment. Because more Wisconsin residents worked in Minnesota than the reverse, Wisconsin made compensation payments to Minnesota. Wisconsin's final reciprocity payment for tax year 2009 totaled $59.7 million, including adjustments for prior tax years and interest.

2. On September 18, 2009, Minnesota Governor Tim Pawlenty informed Wisconsin Governor Jim Doyle that the Minnesota Commissioner of Revenue was exercising his authority to discontinue the two states' income tax reciprocity agreement as of tax year 2010. Minnesota state law authorizes the Minnesota Commissioner of Revenue to cancel the agreement when "it is deemed to be in the best interests of the people of this state." The Wisconsin statutes do not convey similar authority to its DOR Secretary.

3. The primary benefit of reciprocity agreements is that border-crossing taxpayers are required to file a return and pay income taxes only in their state of residence. Since reciprocity with Minnesota ended, Wisconsin residents who work in Minnesota are required to file income tax returns both with Minnesota and with Wisconsin. Similarly, Minnesota residents working in Wisconsin file income tax returns both with Wisconsin and with Minnesota. Each state offers a credit for taxes paid in other states, so that income is not double-taxed. Wisconsin's credit is nonrefundable and equals the entire amount of taxes paid in other states. Minnesota, like most other states with an individual income tax, limits its credit to the amount of taxes that would have been owed on the income if it had been earned in Minnesota.

4. Due to differences in state tax laws, reciprocity agreements will reduce the total income tax liability of some border-crossers. The remaining border-crossers will pay the same amount of tax, but no border-crossers experience a tax increase with reciprocity. Therefore, the combined tax revenues of both states are reduced when a reciprocity agreement is implemented.

5. At the time of the agreement's cancellation, Minnesota officials raised three concerns. First, the compensatory payment occurred at a much later date than actual tax payments occur due to wage withholding. Second, Minnesota believed the number of border crossers was undercounted. Finally, Minnesota sought to be compensated for the full amount of its revenue loss. An attempt to revive the reciprocity agreement shortly after its cancellation resolved the first two issues. Wisconsin agreed to make quarterly estimated payments that mirrored the timing of actual tax receipts, and the two states agreed to a new benchmark study that measured the tax impact of actual border crossers.

6. As noted above, reciprocity causes the combined tax revenues of the reciprocal states to be reduced because some taxpayers will pay less in taxes. Based on the benchmark study of tax year 2011 and accounting for tax changes that have occurred in each state since then, the difference between each state being fully compensated is estimated at $10.6 million for tax year 2015 and $10.5 million for tax year 2016. If reciprocity was implemented in tax year 2016 without a compensatory payment, Wisconsin would experience a revenue gain estimated at $86.3 million, and Minnesota would experience a revenue loss estimated at $96.8 million.

7. Given the $10.5 million gap illustrated above, it is difficult to structure a compensation payment that would be acceptable to each state. Nonetheless, Representative Greg Davids, Chair of the Committee on Taxes, has introduced a bill (H.F. No. 1005) in the Minnesota House of Representatives that addresses this issue. Currently, Minnesota statutes require Wisconsin's compensatory payment to equal Minnesota's net revenue loss, defined as "the difference between the amount of Minnesota income taxes Minnesota foregoes by not taxing Wisconsin residents on income subject to reciprocity and the credit Minnesota would have been required to give under …

(Minnesota state law) to Minnesota residents working in Wisconsin had there not been reciprocity." The bill would repeal the payment calculation's inclusion of the credit for taxes paid to other states, which could be claimed by Minnesota taxpayers in the absence of reciprocity. In addition, the bill would redefine net revenue loss as income taxes foregone by Minnesota "less the cost of providing refundable credits in excess of liability … to Wisconsin residents." Minnesota's DOR has characterized the proposal as implementing a calculation procedure that is similar to the payment calculation that was employed under the cancelled agreement and reflects "Wisconsin's position in negotiations since termination."

8. As noted above, reciprocity has the effect of reducing tax collections. The Minnesota DOR has estimated that H.F. No. 1005 would have a negative effect on the Minnesota general fund estimated at $7.5 million in 2015-16 and $5.2 million in 2016-17. Because the bill would be retroactive to tax year 2015, a one-time effect would occur in 2015-16, and the ongoing effect is estimated in excess of $5 million annually. By implication, Wisconsin's revenue loss under an agreement permitted under the bill would also be an amount in excess of $5 million since the combined revenue loss for tax year 2016 is estimated at $10.5 million.

9. The Wisconsin DOR Secretary has indicated that Wisconsin's reciprocity statute prohibits a reciprocity agreement with Minnesota that reflects Minnesota's current law provisions. However, such an agreement may be possible if H.R. No. 1005 becomes law, provided Wisconsin's payment would be calculated similarly to the payment under the terminated agreement. In that event, Wisconsin would recognize a revenue gain offset by a similar, but larger, expenditure increase. The agreement would have a negative effect on the state's general fund, estimated at more than $5 million annually, depending on how the agreement would be structured.

10. Currently, the DOR Secretary has the authority to unilaterally negotiate a reciprocity agreement with Minnesota, so long as that agreement conforms to current law requirements. Given the fiscal implications of such an agreement, the Legislature may want to have some input. Any reciprocity agreement with Minnesota would most likely be finalized in the fall of one year, so employers could make withholding changes effective at the beginning of the next tax year. The Legislature could require such an agreement be approved by the Joint Committee on Finance through the s. 13.10 process since the Committee typically holds a meeting in the fall of each year.

11. Another option would be to modify the DOR Secretary's authority by specifying that the terms of any agreement negotiated by the DOR Secretary be enumerated in state law. Under this alternative, no agreement would take effect until the Legislature enacts a law specifying the procedures used to calculate the compensation payment, the payment date or dates, the conditions constituting delinquency, interest rates, and the method of computing interest due on any delinquent amounts. Upon reaching an agreement with Minnesota, the Wisconsin DOR Secretary would be required to submit legislation to the Joint Committee on Finance for introduction to the Legislature.

ALTERNATIVES

1. Modify current law provisions related to Minnesota income tax reciprocity to prohibit any agreement with the state of Minnesota from taking effect unless the agreement is approved by

the Joint Committee on Finance under the procedures authorized under s. 13.10 of the statutes.

2. Modify current law provisions related to Minnesota income tax reciprocity to prohibit any agreement with the state of Minnesota from taking effect unless the terms of the agreement are enacted in state law. Upon reaching an agreement with Minnesota, require the Secretary of DOR to submit legislation to the Co-chairs of the Joint Committee on Finance for introduction to the Legislature. Require the legislation to include the procedures used to calculate the compensation payment, the payment date or dates, the conditions constituting delinquency, interest rates, and the method of computing interest due on any delinquent amounts.

3. Maintain current law.

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