



Legislative Fiscal Bureau

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October 9, 2009

TO: Senator Mark Miller, Senate Chair
Representative Mark Pocan, Assembly Chair
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Minnesota/Wisconsin Income Tax Reciprocity

On September 18, 2009, Minnesota Governor Tim Pawlenty sent a letter to Governor Doyle indicating that, "the Minnesota Commissioner of Revenue is exercising his authority granted under Minnesota Statute 290.081(b) to discontinue the income tax reciprocity agreement with Wisconsin. As a result, the reciprocity provisions of Minnesota Statutes 290.081(a) will no longer apply to residents of Wisconsin for income earned in tax years beginning after December 31, 2009."

Under the reciprocity agreement, the Minnesota Commissioner of Revenue may unilaterally terminate the reciprocity provisions. Governor Pawlenty's letter of September 18 indicates that the Commissioner is exercising that option.

The purpose of this memorandum is to briefly explain the reciprocity program and identify the potential fiscal effect of termination of the agreement on Wisconsin's 2009-11 general fund budget.

Minnesota/Wisconsin Income Tax Reciprocity

The Minnesota/Wisconsin reciprocity agreement has been in effect since 1968. The primary benefit of the agreement is that border-crossing taxpayers are required to file a return and pay taxes only in their state of residence. Without reciprocity, such taxpayers would need to file a return in both states. There are approximately 80,000 individuals who file their returns under the agreement -- 57,000 reside in Wisconsin and work in Minnesota, and 23,000 reside in Minnesota and work in Wisconsin.

Under the agreement, a compensation payment is made when the net foregone tax revenues of one state exceed those of the other state. Primarily due to the fact that there are 34,000 more Wisconsin residents than Minnesota residents under the program, Wisconsin makes an annual payment to Minnesota. The payment is made from a general purpose revenue (GPR) sum sufficient appropriation. Payment is made in December for the prior tax year. Thus, in December, 2009, Wisconsin will make a payment to Minnesota for net foregone revenue for the 2008 tax year. In addition, an interest payment is computed from July of the tax year to December in the following year when the payment is made. The following table identifies payment amounts (in millions) for the tax years 2003 to 2007 and estimated amounts for 2008 (to be paid in December, 2009) and 2009 (to be paid in December, 2010).

<u>Tax Year</u>	<u>Fiscal Year Payment</u>	<u>Taxes Foregone by Minnesota</u>	<u>Taxes Foregone by Wisconsin</u>	<u>Difference</u>	<u>Interest Payment</u>	<u>Total Amount Paid by Wisconsin</u>
2003	2004-05	\$64.3	\$17.4	\$46.9	\$2.9	\$49.8
2004	2005-06	72.2	18.5	53.7	3.1	56.8
2005	2006-07	79.1	20.1	59.0	4.4	63.4
2006	2007-08	84.0	21.5	62.5	6.5	69.0
2007	2008-09	90.0	21.8	68.2	7.7	75.9
2008*	2009-10	83.7	20.1	63.6	5.5	69.1
2009*	2010-11	84.0	19.8	64.2	3.4	67.6

*Estimated by the Wisconsin Department of Revenue, and reflects changes to 2009 Act 28 amounts.

Fiscal Effect of Terminating the Agreement

This section identifies the estimated effect of terminating the agreement on Wisconsin's general fund for 2009-11. The figures are based upon preliminary estimates made by the Wisconsin Department of Revenue.

Effective January 1, 2010, income tax withholding amounts will be sent to the revenue department of the state where the income is earned. Thus, rather than Minnesota employers sending withholding amounts to Wisconsin, they will be sent to Minnesota. Likewise, Wisconsin employers will send withholding amounts to Wisconsin, rather than Minnesota, for those Minnesota residents who work in Wisconsin. The net reduced withholding amount for Wisconsin is estimated at \$36.7 million for 2009-10 (January 1, 2010, to June 30, 2010) and \$74.6 million for 2010-11 (July 1, 2010, to June 30, 2011). For the biennium, the general fund revenue reduction is estimated at \$111.3 million.

In Wisconsin's 2009-11 budget (2009 Act 28), \$81.9 million was appropriated for payment to Minnesota in December, 2009, and \$88.5 million was budgeted for payment in December, 2010, under the agreement. Recent estimates by the Department of Revenue indicate that these payments might be \$69.1 million and \$67.6 million, respectively. In that case, the payments over the

biennium would be \$33.7 million less than appropriated (\$12.8 million in 2009-10 and \$20.9 million in 2010-11).

In summary, the general fund effect of terminating the agreement will be a revenue loss to Wisconsin of \$111.3 million. The estimated payments to Minnesota for the biennium will be \$33.7 million less than appropriated in Act 28. Therefore, although the two items are independent of each other, the estimated net effect on the 2009-11 general fund balance is -\$77.6 million.

In future years the tax revenue loss will continue to occur but there will be no offsetting payment to Minnesota.

When the 2009-11 budget was enacted into law, it was estimated that the gross general fund balance at the end of the biennium would be \$275.1 million. After consideration of the \$65.0 million required statutory balance, the net ending balance would be \$210.1 million. The \$77.6 million reduction indicated above would lower the net balance to \$132.5 million.

It should be noted that by October 15, the Department of Administration will publish the state's annual report for the 2008-09 fiscal year. That report will show actual revenue and expenditure data for 2008-09. It will indicate the ending balance for 2008-09 (opening balance for 2009-10) which might affect the balance amounts identified above.

BL/sas

cc: Members, Wisconsin Legislature