Report on the Advisability of Terminating Individual Income Tax Reciprocity With the State of Wisconsin

Commissioner of Revenue

March 1, 2002

MINNESOTA · REVENUE

March 1, 2002

The Honorable Lawrence J. Pogemiller
Chair, Senate Committee on Taxes
Room 235, State Capitol
75 Constitution Avenue
St. Paul, Minnesota 55155

The Honorable Ron Abrams
Chair, House Committee on Taxes
Room 585, State Office Building
100 Constitution Avenue
St. Paul, Minnesota 55155

Dear Senator Pogemiller and Representative Abrams:

Attached is the report mandated under Laws 2001, First Special Session, Chapter 5, Article 7, Section 64, to report to the Legislature on the advisability of terminating individual income tax reciprocity with the State of Wisconsin.

The report is intended to provide additional information as background to the Governor's budget recommendation to discontinue the agreement.

I would like to emphasize that the recommendation in the report includes the removal of the statutory linkage between income tax reciprocity and higher education tuition reciprocity, so that changes in income tax reciprocity would not automatically affect tuition reciprocity. Any policy discussions on tuition reciprocity should occur separately.

Minnesota Statutes, Section 3.197, specifies that a report to the Legislature must include the cost of its preparation. The approximate cost of preparing this report was $2,500.

Sincerely,

Matthew G. Smith
Commissioner

cc: Secretary of the Senate
Chief Clerk of the House
Legislative Reference Library - 6 copies

Executive Summary

Background

Income tax reciprocity is a formal legal arrangement designed to relieve taxpayers who are residents of one state but work in another the burden of filing two state income tax returns. Without reciprocity, a taxpayer would be required to file a return in both the state of residence and in the state where they work. Income tax would be paid to the state of employment, and then a credit would be claimed on the return for the state of residence.

Under Minnesota Statutes, Section 290.081, the Commissioner of Revenue is authorized to enter into income tax reciprocity agreements with other states. Minnesota has reciprocity agreements with three states: Michigan, North Dakota, and Wisconsin. With Michigan the number of taxpayers involved is relatively small, and with North Dakota the number from each state is similar. However, that is not the case with Wisconsin. The ratio of Wisconsin residents who work in Minnesota is approximately twice the number who reside in Minnesota but earn a living in Wisconsin. Also, the Wisconsin residents who work in Minnesota tend to have higher incomes than their Minnesota counterparts. Because the numbers are very disproportionate, reciprocity alone would mean that Minnesota would forgo a substantial amount of income tax revenue.

The reciprocity agreement with Wisconsin was signed on November 14, 1967, and went into effect for tax year 1968. This original agreement did not involve any payment from Wisconsin to Minnesota for lost revenue. At that time the number of taxpayers who lived and worked in one or the other of the two states was much smaller. However, as development patterns along the border began to unfold in the early 70s, more and more taxpayers were living in Wisconsin and working in Minnesota. This resulted in large amounts of revenue being lost due to reciprocity. In response, Minnesota proposed ending reciprocity to stop the ever-increasing loss of income tax revenues.

When confronted with the possibility of actually ending reciprocity with Minnesota, Wisconsin sought a way to preserve the arrangement. The outcome was that Wisconsin agreed to pay Minnesota an amount designed to compensate Minnesota for its net revenue loss. By agreeing to make annual payments to Minnesota, Wisconsin preserved reciprocity for its residents which are the majority of the beneficiaries. The first payment from Wisconsin was received in 1975.

Since the payment system began, development patterns along the border between the two states have continued to favor Wisconsin as the major beneficiary of reciprocity. More people chose to live in Wisconsin and work in Minnesota than commute from Minnesota to a job in Wisconsin. This development pattern has steadily increased, particularly in the 1990s.

Issue

Periodic studies have been conducted jointly by the two states to determine how many taxpayers are residents of one state and work in the other. In 1995, both Wisconsin and Minnesota funded such a study, referred to as a benchmark study, to calibrate the amount of the annual payment made by Wisconsin for tax year 1995. While most of the work associated with the study has been completed, it raised the issue of the accuracy associated with the method used to calculate the annual payment to Minnesota. The payment calculation method does not compensate Minnesota for its “net revenue loss” as Minnesota and Wisconsin statutes stipulate.

As a result, Wisconsin was contacted several times to see if a change in the method could be agreed upon that would adhere to the laws of both states. A series of exchanges have taken place over a number of years, culminating in a face-to-face meeting between the Minnesota Commissioner of Revenue and the Wisconsin Secretary of Revenue in Madison on November 20, 2001, to try to work out an agreeable arrangement. To date, it appears these efforts have been in vain. Minnesota is now faced with a choice: continue reciprocity with Wisconsin under the current arrangement, which is inconsistent with the law and costs the state general fund revenue; or terminate our agreement with Wisconsin.

Recommendation

After consideration of the options and in the face of Wisconsin's unwillingness to alter its current position, it was recommended as part of the Governor's 2002 supplemental budget recommendation that income tax reciprocity with Wisconsin be terminated. The primary reason for this recommendation is one of fairness. Because Minnesota is not fully compensated for its loss, additional taxes are paid by other taxpayers.

To underscore this point, the permanent ongoing revenue loss to Minnesota under the current system is $8 million per year, which translates into an extra $3 being added to each tax return in order to subsidize Wisconsin's budget annually. Looked at another way, if reciprocity is eliminated, a tax cut of the same amount could be offered to all of Minnesota's income taxpayers and the Minnesota revenue picture would be unchanged.

It also recommended that the current law linkage in statute between income tax reciprocity and higher education tuition reciprocity be removed so that tuition reciprocity with Wisconsin can be evaluated as a separate issue.

Because Minnesota experiences an ongoing revenue loss under the current system, Minnesota will realize a revenue increase from ending reciprocity. While taxpayers will be inconvenienced to some extent by having to file two returns, the burden of filing tax returns has been lessened by electronic filing and the use of computers in tax preparation for many filers. Some employers will have to alter their withholding practices, but many will benefit from having to withhold for only one state instead of two. Both states will see an increase in the number of returns that are processed. In all cases dealing with the number of taxpayers and their tax returns, the number of taxpayers impacted by ending reciprocity is twice as great for Wisconsin as for Minnesota.

Revenue Estimate

Following is a table showing the revenue gain from ending reciprocity with Wisconsin, effective beginning with tax year 2003. Due to timing differences between the payments received from Wisconsin and the revenue Minnesota would realize when reciprocity is terminated, a large one-time gain would result in fiscal years 2003 and 2004, in addition to the ongoing revenue increase.

	FY 2003	**FY 2004**	**FY 2005**
		($ 000s)	
With reciprocity, current practice			
Payment from Wisconsin	$49,300	$55,000	$57,900
	(TY 01)	*(TY 02)*	*(TY 03)*
If reciprocity terminated for tax year 2003 and after			
Payment from Wisconsin	$49,300	$55,000	-0-
Income tax revenues	$30,000	$62,100	$66,100
Total Revenues	$79,300	$117,100	$66,100
Increase in Revenue	**$30,000**	**$62,100**	**$8,200**

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Background

What is Income Tax Reciprocity?

In general, wages and similar types of income are taxed in the state where they are earned. Individuals are also taxed on all income in their state of residence. If a resident of one state earns wage income in another state, tax is paid on the wage income to the state of employment, and a credit for that tax is allowed against the tax paid to the person's home state.

Reciprocity is an exception to this principle of state taxation. When two states enter into a reciprocal income tax agreement, residents of one state who work in the other state pay tax on their wage income only to their home state.

Reciprocal income tax agreements apply to wages, salaries, and similar types of compensation earned by an employee. In some cases, including the Minnesota-Wisconsin agreement, reciprocity also applies to income earned from personal or professional services by a self-employed person, including proprietors and partners.

Note: In this discussion, the term "wages" is used to refer to all types of income subject to reciprocity.

Reciprocity potentially benefits the resident of one state who works in the other in two ways:

- If the person has no other income in the state of employment, they file an income tax return only in the home state.
- If the income tax burden in the state of employment is higher than in the home state, the person could pay less in total state taxes.

The discussion of income tax reciprocity usually focuses on commuters, that is, people who live in one state and each day drive back and forth to work at a job in the other state, such as at an office, store, or factory. However, other types of situations are affected by reciprocity. It should be noted that the person does not necessarily have to be living in the home state for reciprocity to apply. Reciprocity is based on residency, not where a person is living at the time.

Besides commuters, reciprocity applies to other situations, including:

- Person working at one or more construction sites.
- Person, such as a plumber, who works at many locations during the year.
- Person, such as a consultant, who works at a client's location.
- Student who works part time while attending college.
- Person working at a seasonal job, such as at a resort.
- A professional athlete who plays one or more games in the other state.
- Temporary agency employee with various assignments.
- Employee who temporarily works at another location of the employer.

Employers and Withholding

Employers are required to withhold tax for the state in which wages are earned, and reciprocity is an exception to those requirements. The effect of reciprocity on withholding is not automatic; the employer and the employee must take certain action.

- The employee must notify the employer and verify their residency in the other state in order to be exempt from withholding for the state of employment. In Minnesota and Wisconsin, the verification must be done annually by means of an affidavit filed with the employer.
- The employer keeps one copy of the affidavit and sends one copy to the Department of Revenue in the state of employment.
- The employer may be required to withhold tax for the state of residence based on nexus in the other state or may choose to do so for the convenience of the employee. Otherwise the employee makes quarterly estimated payments to the state of residence.
- If the employee fails to notify the employer or does so only later in the year, the employee must file a return in the state of employment to obtain a refund of tax withheld.

Reciprocity results in an additional administrative burden for employers. In the absence of reciprocity, state tax withholding is handled the same for all employees, and for employees working at a given location, withholding is reported and remitted to only one state.

Withholding at the source of income is an effective and efficient tool for compliance with the individual income tax. The exception for reciprocity income opens up the possibility of tax avoidance if the employer does not withhold tax for the state of residence. Enforcement then requires cooperative efforts between the two states and/or matching against federal filings.

Taxpayer Convenience

The stated purpose of reciprocity is convenience to taxpayers which does occur for taxpayers whose only income in the other state is that covered by reciprocity. If the person also has, for example, business or rental income in the other state, they will have to file returns in both states.

Taxpayer convenience is the only effect of reciprocity if all of these conditions are true:

- The income tax burdens in the two states are the same,
- The number of residents who work in the other state is the same, and
- The wage levels of those workers are the same.

Because all of these conditions do not exist, the effects of reciprocity extend beyond taxpayer convenience. In the case of Minnesota and Wisconsin, none of the conditions exists.

Reciprocity Can Affect the Tax Burden of Individuals

Without reciprocity, the total tax burden is equal to the tax in the home tax or in the state of employment, whichever is higher. Under reciprocity, the tax burden is that of the home state. If the taxes in the state of employment are higher than in the home state, the person benefits by a reduction in total state taxes. If the reverse is true, the person’s tax burden does not change.

If the tax in one state is significantly higher than the other state in all cases, then reciprocity results in a large tax break for the residents of one state and no tax break for the residents of the other state. When this occurs, individuals and businesses may make decisions based on whether or not there is income tax reciprocity. Such is not the case with Minnesota and Wisconsin.

Impact of Reciprocity on State Revenues

When the tax burdens in the two states are different, then total taxes in one or both states are reduced by having reciprocity. Reciprocity results in either increased taxes for the rest of the taxpayers of the state or in a reduction in state spending.

When there is an imbalance in the number of residents who work in the other state and in the level of their wages, reciprocity can result in a shift of revenues between the two states. If these factors are offsetting, the revenue shift between the two states may be minimized. If one state has many more residents working in the other state and the level of their wages is much higher, then reciprocity can result in a large shift of revenues between the two states. Such an imbalance usually precludes the adoption of a reciprocity agreement.

Differences in all three factors – tax burden, number of residents working in the other state, and their level of wages – can result in a shifting of revenues between the two states and in lower combined revenues. All of these factors occur in Minnesota-Wisconsin reciprocity.

Current Reciprocity Agreements

Of the 41 states that have an income tax on wage income, 15 states, including Minnesota, have reciprocity with one or more other states. Minnesota has had reciprocity with Wisconsin since 1968, North Dakota since 1969, and Michigan since 1984. Reimbursement provisions currently exist for two reciprocity agreements: Wisconsin makes annual payments to Minnesota and also to Illinois.

Recent Developments in Other States

A 1997 Illinois law required the Illinois Department of Revenue to report on the fiscal impact of its existing income tax reciprocity agreements. If it was determined that the reciprocal agreement with a state resulted in a revenue loss to the State of Illinois, the agreement would be revoked unless the other state agreed to compensate Illinois for its loss.

Illinois-Indiana: Indiana did not agree to pay Illinois, and reciprocity between Illinois and Indiana was terminated, effective with tax year 1998. It appears very unlikely that a new agreement will be negotiated.

Illinois-Wisconsin**:** In 1998 Wisconsin agreed to compensate Illinois and has been making annual payments.

Iowa-Illinois**:** In January 2002 the Governor of Iowa announced plans to terminate reciprocity with Illinois, effective July 1, 2002, because Iowa is losing an estimated $16 million per year. It is possible that reciprocity could be retained if Illinois agrees to compensate Iowa for its loss.

History of Minnesota-Wisconsin Income Tax Reciprocity

Authority for Minnesota to enter into an income tax reciprocity agreement with another state was enacted in 1967. A reciprocity agreement between Minnesota and Wisconsin was signed on November 14, 1967, effective beginning with tax year 1968. Minnesota also entered into reciprocity agreements with North Dakota in 1969 and Michigan in 1984.

In 1973, Governor Wendell Anderson proposed the repeal of income tax reciprocity because it caused a revenue loss to Minnesota. The revenue issue involved primarily the Minnesota-Wisconsin agreement. Wisconsin Governor Patrick Lucey thought that it was important to keep reciprocity with Minnesota. In order to meet the goals of both governors, a reimbursement provision was enacted in both states, beginning with tax year 1973. Reciprocity was retained, and Wisconsin would make annual payments to reimburse Minnesota for its **net revenue loss,** defined as the amount of revenue that Minnesota would receive in the absence of reciprocity. The reimbursement provision would have the same fiscal impact on Minnesota's budget as the repeal of reciprocity.

The Departments of Revenue in the two states determine the payment amount. If they cannot agree, the law provides for a board of arbitration to make the final decision.

A timeline of events relating to the reciprocity payments is included in the Appendix. For tax year 1973, the two states could not agree, and the matter was submitted to a board of arbitration. The issues involved data sources and statistical methods. As part of its findings, the board recommended that the two states contract with a third party to determine a methodology that the two states could then use in the future. Such a study was done on the 1976 returns, and the reciprocity agreement was modified to adopt the methods used in that study. Since that time there have been few issues between the two states involving data or statistical methods.

The method of calculating the payment adopted from the 1976 study is valid as long as the Minnesota tax burden is higher than that in Wisconsin. Even though the wording is misleading, the payment would be the correct amount. The perception in the 1970s was that Minnesota income taxes were always higher than Wisconsin. That was not the case then, and it certainly is not the case today.

The Minnesota Department of Revenue brought this issue to the attention of the Wisconsin Department of Revenue in doing the 1995 benchmark study. It was pointed out that the current method of calculating the payment was in conflict with the law and did not fully compensate Minnesota for its **net revenue loss**. Correspondence and discussion regarding this issue took place between the two departments at various levels from 1996 to 2000. (Copies of the correspondence are included in the Appendix.)

In May of 2000, an impasse was reached when the Wisconsin Department of Revenue made clear their contention that the current method is consistent with the law, and for that reason they would not go to arbitration. The impasse is centered on Wisconsin's interpretation of the law governing reciprocity. The two states use the same data and statistical methods, but it is how they are applied in the calculation of "net revenue loss" that is the crux of the issue. It is clear that Minnesota is not being compensated for its net revenue loss, and therefore the current method is inconsistent with the law.

Problems with the Current Payment

The Minnesota-Wisconsin income tax reciprocity agreement has resulted in an annual net revenue gain for Wisconsin and an annual net revenue loss for Minnesota since it took effect in 1968. Even though Wisconsin makes annual payments to Minnesota, Wisconsin still has a significant gain and Minnesota a significant loss because:

- Minnesota is not fully compensated for its net revenue loss on a tax-year basis.
- Even if Minnesota were fully compensated for its loss on a tax-year basis, the payment schedule results in a large cash flow gain to Wisconsin and a corresponding cash flow loss to Minnesota.

Under the current calculation and timing of the payment from Wisconsin, reciprocity results in an ongoing revenue loss to Minnesota of at least $8 million per year. The $8 million does not include the loss of investment interest.

Source of the Dispute Between the Two States: What the Payment Should Measure

The disagreement between the two states has involved the interpretation of the law regarding what the payment should measure.

Minnesota's position is that the payment from Wisconsin should reimburse Minnesota for its net revenue loss due to reciprocity. This position is based on the wording of the statutes of both states and is supported by the intent and historical context of the 1973 legislation.

Wisconsin's position is that the current method of determining the payment is consistent with their statute. They acknowledge that the payment does not fully compensate Minnesota for its net revenue loss, but they contend that is not its purpose.

The payment is the net of two amounts. The two states agree on the first amount – it is the Minnesota tax that would be paid by Wisconsin residents. The dispute is what should be subtracted from that amount to determine the payment.

Under Wisconsin's position and the current method, the amount subtracted is the Wisconsin tax that would be paid by Minnesota residents. The payment is described as the difference between "taxes foregone by Minnesota and taxes foregone by Wisconsin".

Minnesota's position is that the purpose of the calculation is to determine Minnesota's net revenue loss, as stated in the law, not the difference between the two states. Therefore, the amount subtracted should be the credit that, in the absence of reciprocity, Minnesota would allow to its residents for tax paid to Wisconsin.

The Minnesota credit for tax paid to other states is a nonrefundable credit and cannot exceed the Minnesota tax on the same income. When the Wisconsin tax on a Minnesota resident's wages is higher than the Minnesota tax on the same income, the limitation applies. The Wisconsin credit for tax paid to other states would be limited in a similar manner for a taxpayer whose only income is from wages earned in Minnesota.

If the Minnesota tax were always higher than the Wisconsin tax, then the credit on the Minnesota return would be equal to the Wisconsin tax, and the payment amount would be the same under both interpretations.

The difference between the Wisconsin tax and the credit that Minnesota would allow was not measured until the 1995 benchmark study. In that study the limitation applied to about 60% of the Minnesota residents who would pay tax to Wisconsin.

For the most recent payment which was made in December 2001 for tax year 2000, the amounts calculated under the two positions are:

Minnesota's Position:

MN tax on WI residents	$64,758,000
Credit for tax paid to WI	-$14,839,000
MN net revenue loss	$49,919,000

Wisconsin's Position:

MN tax on WI residents	$64,758,000
WI tax on MN residents	-$16,858,000
Current Payment	$47,900,000

Difference in Payment:

MN net revenue loss	$49,919,000
Current payment	- $47,900,000
Difference	$2,019,000

For tax years 2001 through 2005, the difference between the two methods ranges from $2 million to $2.5 million per year, based on current projections

Cash Flow of Annual Payments Compared to Income Tax Revenues

Minnesota's loss (and Wisconsin's gain) from the lag in payments is greater than and in addition to its loss due to the method of calculating the payment. There is an average delay of eighteen months between when revenues would be received without reciprocity and the time of payment from Wisconsin.

In the absence of reciprocity, Minnesota would have received additional revenues for tax year 2000 in fiscal years 2000 and 2001, roughly one-half in each year. Under the current method, Minnesota received a payment from Wisconsin in December 2001 (fiscal year 2002).

Looking at the Wisconsin side of the ledger, the current method, compared to no reciprocity, resulted in Wisconsin receiving higher revenues for tax year 2000 in fiscal years 2000 and 2001 and then waiting until the middle of fiscal year 2002 to reimburse Minnesota.

On a fiscal year basis, the difference in cash flow for Minnesota ranges from $5.5 million to $6 million per year. In fiscal year 2005, for example, the difference in cash flow of $5.8 million is due to the difference between a payment from Wisconsin for tax year 2003 and revenues, in the absence of reciprocity, from one-half of tax year 2004 and one-half of tax year 2005.

Benchmark Studies

A benchmark study is done by both states for a given tax year. The purpose of a benchmark study is to determine what the tax burden would be in the absence of reciprocity for taxpayers who have reciprocity income.

A benchmark study is a simulation of the repeal of reciprocity except that the burden for computing the tax in the state of employment is not on the taxpayers but on the Revenue Departments in the two states. The Revenue Departments have the added task of identifying taxpayers affected by reciprocity and determining the amount of their reciprocity income.

The frequency of benchmark studies is not specified in the law or in the reciprocity agreement. The Revenue Departments in the two states must agree to do a study, and each must obtain funding to carry out the study. In the 29 years since the reimbursement provisions were enacted, benchmark studies have been done for only four tax years: 1973, 1976, 1983, and 1995.

Benchmark studies have not been done more often because they require a significant commitment of resources. For the 1995 study, the Minnesota Legislature appropriated $150,000 to the Department of Revenue, and the Wisconsin Legislature appropriated a similar amount. The $150,000 for Minnesota was used for six temporary employees who reviewed the returns, computer time, data entry, postage, and other identifiable costs. The appropriation did not include Department of Revenue staff who did all the planning and project design, consultation with the Wisconsin Department of Revenue, computer programming, training and supervising of temporary employees, and summary and analysis of the study results.

Another reason that the studies have not been done more often is that both states must be willing and able to do the study at the same time. Parallel studies are done by both states. As much as possible, everything is done the same way in both states in order to minimize any differences in study results that could be attributed to differences in procedures.

The results of the most recent benchmark study are used to calculate the payment for the benchmark year, the three preceding years, and subsequent years. The benchmark results are applied to a given year by adjusting for individual income tax receipts for the most recent fiscal year for Minnesota and Wisconsin and for the most recent annual population figures by county from the U.S. Census Bureau for both states. When a payment for a tax year has already been made prior to the completion of a study, the study results are used to adjust the payment amount. Therefore, the annual payment made in December can include adjustments for prior years.

The 1995 Benchmark Study

A question was placed on the 1995 income tax return of each state asking taxpayers if they had reciprocity income in the other state and, if so, how much. The wording of the question, its placement on the return, and the wording of the instructions had to be the same in both states.

Three sources of data were used to identify taxpayers potentially affected by reciprocity: the answer to the question on the 1995 return, affidavits for exemption from withholding due to reciprocity, and returns filed in the other state for a refund of all their withholding. The last two data sources involved each state gathering data from its own sources and then sending it to the other state. These returns were supplemented with a random sample stratified by county and income to identify taxpayers who were not included in the other data sources.

Each return identified as potentially having reciprocity income was pulled and reviewed by a person to determine if the taxpayer and/or spouse did have reciprocity income and, if so, how much. The two states had to agree on a decision table for determining if the person had reciprocity income by examining the evidence from various sources. When a determination could not be made from the available information, a letter and questionnaire were sent to the taxpayer.

Minnesota identified 20,741 people on 19,522 returns with Wisconsin reciprocity income, and Wisconsin identified 47,856 people on 42,478 returns with Minnesota reciprocity income.

For each return with reciprocity income, the amount of reciprocity income and other data items from the state and federal returns were entered. The data was run against a computer program developed by each state to calculate the tax burden as if the person filed a nonresident return in the other state. Minnesota also calculated the credit that would be allowed on the Minnesota return for tax paid to Wisconsin.

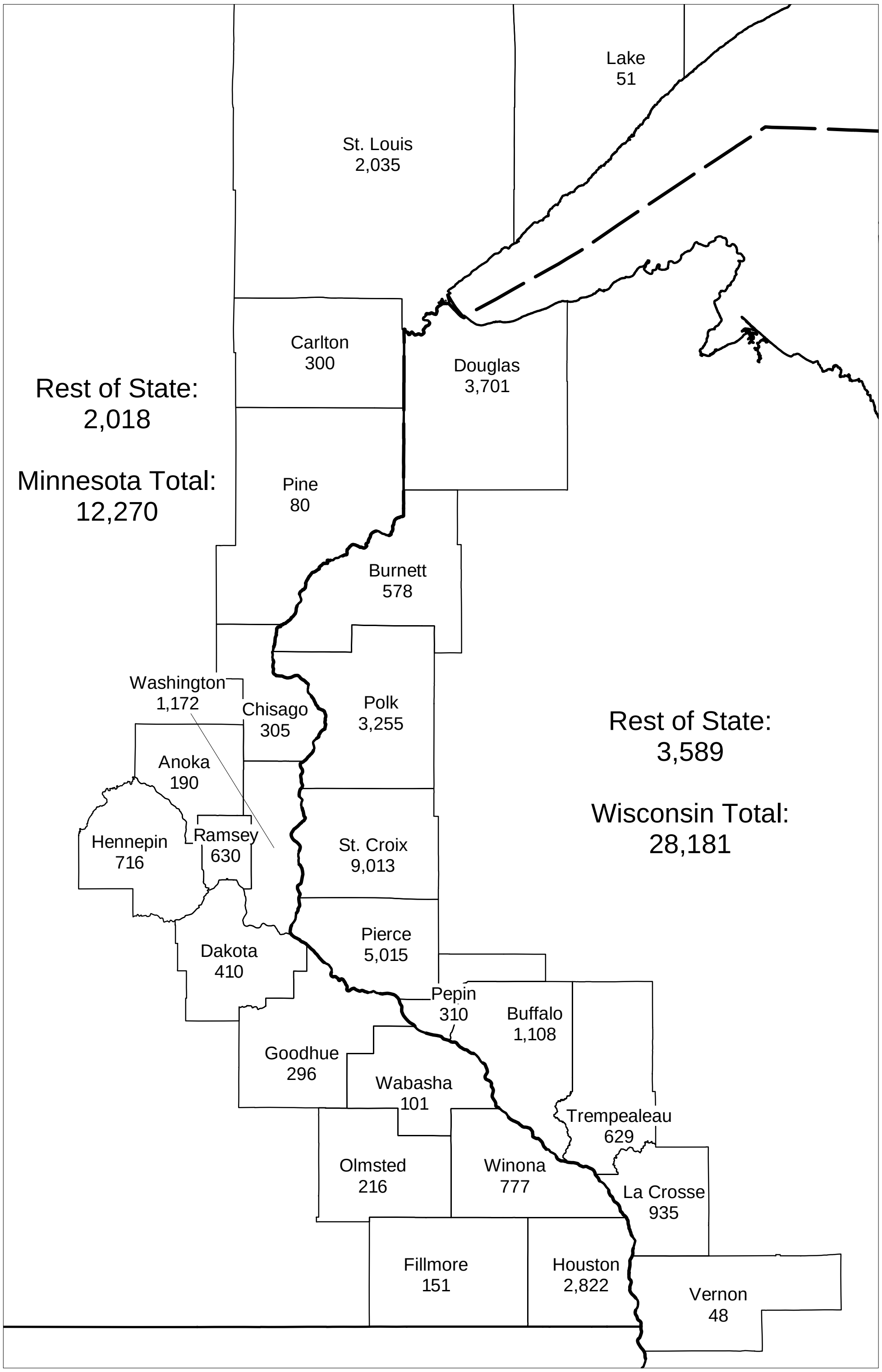
It was determined that 12,270 Minnesota returns would have Wisconsin tax and 28,181 Wisconsin returns would have Minnesota tax. The map on next page shows the location of these returns by county of residence. The large differences between the number with reciprocity income and the number with tax in the other state are due to people who had only a small amount of reciprocity income. Most of these people would not meet the filing requirements in the other state.

The results of the 1995 study have been used for the annual payments since December 1998. Minnesota's position is that the results of the study are tentative because the issue of what the payment should measure has not been resolved. Wisconsin contends that 1995 study results are final.

1995 Minnesota-Wisconsin Benchmark Study

Number of Returns with Tax on Reciprocity Income in the Other State

By County of Residence



Minnesota-Wisconsin Tuition Reciprocity

Higher education tuition reciprocity was first authorized by Minnesota statute in 1967, and Minnesota and Wisconsin have had tuition reciprocity since the 1968-69 school year.

Initially, Minnesota allowed an unlimited number of Wisconsin residents to attend college in Minnesota at the resident tuition rate. Wisconsin allowed Minnesota residents to attend college in Wisconsin at the resident tuition rate, but the number was limited to the number of Wisconsin residents who attended college in Minnesota. Therefore, some Minnesota residents attended school in Wisconsin at the resident rate, and others paid the nonresident rate.

In 1973 the Governors of Minnesota and Wisconsin announced that the number of students benefiting from reciprocity would be unlimited and that Minnesota would reimburse Wisconsin for the cost due to difference in the number of students. The announcement was made at the same time that the two governors announced the reimbursement provision for income tax reciprocity. Minnesota and Wisconsin enacted income tax reimbursement in 1973 and tuition reimbursement in 1974.

The Minnesota statute authorizing tuition reimbursement between Minnesota and Wisconsin makes such transfer of funds contingent on the existence of an income tax reciprocity agreement between the two states. Wisconsin law contains no such requirement. If the income tax reciprocity agreement would be terminated without a change to the statute linking the two agreements, tuition reciprocity could be retained but without reimbursement. It is not known if Minnesota and Wisconsin would agree to continue tuition reciprocity if there were no state-to-state reimbursement.

Since the 1975-76 school year, Minnesota has made annual payments to Wisconsin for all but two years. The exceptions were the 1996-97 and 1997-98 school years when Wisconsin paid Minnesota. For the 2000-2001 school year, Minnesota paid Wisconsin $2.4 million. In the fall of 2000, 13,022 Minnesota residents attended school in Wisconsin and 9,414 Wisconsin residents attended school in Minnesota under the reciprocity agreement.

Currently, a Minnesota resident attending a public college or university in Wisconsin pays the same tuition that they would pay at a comparable Minnesota school. Similarly, a Wisconsin resident attending college in Minnesota pays the same tuition that they would pay at a comparable school in Wisconsin.

Minnesota also has tuition reciprocity with North Dakota, South Dakota, and the Province of Manitoba. There is tuition reciprocity with Iowa which is limited to one school in each state. The North Dakota agreement includes a reimbursement provision, and Minnesota paid North Dakota $1.4 million for the 2000-01 school year.

Appendices

Appendix A

Examples: Tax Burden With and Without Reciprocity
Tax Year 2001

Example A: Married Couple Filing Joint Return, $50,000 Income from Wages

Wisconsin tax	$2,498
Minnesota tax	$2,134
Difference	$364

Minnesota Resident Working in Wisconsin

- With reciprocity, couple pays $2,134 to Minnesota.
- Without reciprocity, they pay $2,498 to Wisconsin. Their Minnesota tax is reduced to $0 by the credit for tax paid to Wisconsin.

Wisconsin Resident Working in Minnesota

- With reciprocity, couple pays $2,498 to Wisconsin.
- Without reciprocity, they pay $2,134 to Minnesota and $364 to Wisconsin ($2,498 less $2,134 credit for tax paid to Minnesota).

Example B: Single Person, $40,000 Income from Wages

Wisconsin tax	$2,123
Minnesota tax	$1,986
Difference	$137

Minnesota Resident Working in Wisconsin

- With reciprocity, person pays $1,986 to Minnesota.
- Without reciprocity, person pays $2,123 to Wisconsin. The Minnesota tax is reduced to $0 by the credit for tax paid to Wisconsin.

Wisconsin Resident Working in Minnesota

- With reciprocity, person pays $2,123 to Wisconsin.
- Without reciprocity, person pays $1,986 to Minnesota and $137 to Wisconsin ($2,123 less $1,986 credit for tax paid to Minnesota).

Appendix B

Timeline of Minnesota-Wisconsin Reciprocity

1967 Reciprocity agreement signed, effective beginning with tax year 1968.

1973 Reimbursement provision enacted by both states, beginning with tax year 1973. Similar language in the statutes of both states provides that Wisconsin pays Minnesota each year for its net revenue loss due to reciprocity. This legislation was in response to the Governor of Minnesota's proposal to repeal reciprocity.

1974/5 The two states could not agree on the amount of payment for tax year 1973. Issue went to arbitration, as specified in the laws of both states. Arbitration board determined payment for tax year 1973 and proposed that the two states hire a third party to determine the payment for a subsequent year and to develop a methodology that could be adopted by both states.

1977 Survey Research Center, Institute for Social Research (ISR), University of Michigan, contracted by both states to do a study based on 1976 tax returns.

1978 Results of the study used to determine payments for tax years 1973 to 1977 and for annual adjustments until the next study was done on 1983 returns.

1980 Supplement to agreement signed which incorporated ISR methodology and specified how annual payments are calculated and adjustments made.

1983 Modification to agreement provided for a study using tax year 1983 returns and changed how annual payments and adjustments are determined.

1986 Benchmark study of 1983 returns completed.

1995 Both states agreed to conduct a benchmark study using 1995 tax returns.

1996 Issue of what the payment should measure first brought to the attention of the Wisconsin Department of Revenue.

1998 Benchmark study of 1995 returns completed, pending certain issues to be resolved. Payment made in December 1998 and subsequent years reflected the preliminary 1995 study results.

2000 Correspondence and discussion between the Minnesota Commissioner of Revenue, the Wisconsin Secretary of Revenue, and their staffs reached a point where it was apparent that there would be no resolution of the issue of what the payment should measure.

2001 Minnesota law enacted which requires the Commissioner of Revenue to report to the Tax Committees by March 1, 2002, on the advisability of terminating income tax reciprocity with Wisconsin. A November 20th meeting in Madison between the heads of the two Revenue Departments and their staffs yielded no progress toward resolution.

Appendix C

Correspondence Between the Minnesota and Wisconsin Departments of Revenue

MINNESOTA Department of Revenue

Commissioner's Office

St. Paul, Minnesota 55146-710(

September 28, 2001

Rick Chandler
Secretary of the Department of Revenue
Wisconsin Department of Revenue
P.O. Box 8933
Mailstop 624A
Madison, Wisconsin 53708

Dear Secretary Chandler:

As you may know, over the past several years my staff and I have been in communications with your predecessor about issues involving income tax reciprocity between Minnesota and Wisconsin. In particular, we have been unable to resolve a fundamental disagreement over how the annual payment is calculated and what is owed.

A provision was enacted in the 2001 Minnesota tax bill, Minnesota Session Laws 2001, Special Session, chapter 5, article 7, section 64 (attached) requiring a report to the 2002 Minnesota Legislature on the advisability of terminating individual income tax reciprocity with Wisconsin. In preparing this report, I would like your help in weighing the benefits or negatives of reciprocity agreements between our two states.

As part of the 1995 reciprocity benchmark study, your department determined the number of Wisconsin residents who had Minnesota income subject to reciprocity. In the absence of reciprocity, these taxpayers would be required to file a Minnesota return. However, some would have already filed in Minnesota because they have other types of Minnesota-source income or because they claimed a refund for Minnesota tax withheld.

In order to determine the administrative and taxpayer impacts of eliminating reciprocity, it is important to know the number of additional Minnesota returns that would be required to be filed by Wisconsin residents. We therefore request that the tape (or disk) file containing individual records from the 1995 study be sent to us. We can then match the Wisconsin residents with reciprocity income to our 1995 processing file to determine the number who had filed a Minnesota return. As with other aspects of the study, the confidentiality of taxpayer information would be protected. We will be providing your department with the same information for Minnesota residents with Wisconsin reciprocity income.

There are also policy decisions that need to be considered in either continuing or discontinuing income tax reciprocity with Wisconsin. I would like to meet, with appropriate staff, at the end of October in preparation for our November forecast and 2002 legislative session. We would be happy to join you in Madison. I will have my office contact your office to schedule the meeting.

Sincerely,

Matt Smith (rep)

Matt Smith
Commissioner

State of Wisconsin • DEPARTMENT OF REVENUE

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Tommy G. Thompson
Governor

Cate Zeuske
Secretary of Revenue

January 18, 2001

Mr. Matthew G Smith
Commissioner of Revenue
Minnesota Department of Revenue
600 North Robert Street
St. Paul, Minnesota 55146-7100

Dear Commissioner Smith:

Thank you for your letter asking me to confirm the position of the Wisconsin Department of Revenue outlined in a letter from our agency's chief counsel, John Evans, to Minnesota Revenue's director of Legal Services, Terese Mitchell, dated October 24, 2000. I confirm this position, specifically, that we will not recommend any change in the reciprocity statutes.

Further, the change in the meaning of "net revenue loss," which you propose, is not an arbitrable matter under the statutes of either state or the reciprocity agreement between them. The bulk of Mr. Evans' letter explicated the rationale behind our position.

As Mr. Evans indicated, our review of the historical record demonstrates that there was no change in the calculation of the reciprocity payment in 1980, as your staff has asserted, but that every final reciprocity payment has been calculated using the same method. Further, it showed that our two agencies shared, as far back as 1973, an understanding of "net revenue loss" that underlies this calculation. The new interpretation you propose was first advanced in September of 1996, during work on the 1995 rebenchmark study. Since it is a new interpretation, it clearly requires a statutory change.

You state in your letter that you had hoped our two agencies could have resolved the dispute without recourse to legislative or legal processes. In order to do so, your agency needs to demonstrate its case for the interpretation you are proposing. To this point, you have not substantiated the assertion that an error was introduced into the calculation of the payment in the 1980 supplement to the reciprocity agreement. Nor have you provided documented evidence that "net revenue loss" was ever intended to be something other than the difference between taxes forgone by Minnesota and taxes foregone by Wisconsin.

In regards to other issues you raised in your letter of August 2, 2000, we are willing to consider limiting reciprocity to wages and codifying the frequency, methodology and funding mechanism for the benchmark studies. These changes too, in our opinion, would require legislation. However, resolution of the meaning of "net revenue loss" must take priority.

Finally, because the December 2000 reciprocity payment was calculated on the basis of both states' current statutes, it is a final, and not a preliminary, payment

Sincerely,

Cate Zeuske
Secretary of Revenue

cc: Governor Tommy G. Thompson

MINNESOTA Department of Revenue

Commissioner's Office St. Paul, Minnesota 55146-7100

December 13, 2000

Ms. Cate Zeuske
Secretary of Revenue
Wisconsin Department of Revenue
125 South Webster Street
P.O. Box 8933
Madison, Wisconsin 53708-8933

Dear Secretary Zeuske:

I received a copy of the letter from John Evans, Chief Counsel, to Terese Mitchell, Director of Legal Services for this agency. In response to that letter, I am writing to confirm with you my understanding of your positions regarding what I had asked in my letter dated August 2, 2000.

It seems clear to me that your agency stands firm in your position regarding this dispute and that you will not recommend to your governor or legislature any changes to the statute regarding this issue. It is equally clear that you will not agree to appoint an arbitrator to assist in resolving the issue, because your interpretation of the statute does not permit this. I had also inquired in my earlier letter about a meeting with our staff persons to address this issue and potentially other legislative changes that we could agree to jointly. Since this was not mentioned in the letter from Mr. Evans, I am assuming that this is also not an option at this time.

If any of these assumptions are incorrect, please let me know as soon as possible. I had hoped we could deal with this issue without addressing it through legislative or legal processes. However, at this point I need to reach a resolution. I will be discussing this with Governor Ventura's office and appropriate legislative leadership to convey the potential costs and benefits associated with continuing reciprocity. I still believe that reciprocity is a good mechanism for both states to deal with administrative tax issues that arise when taxpayers are residents of one state and work in another.

In light of our position, I would like to take this opportunity to state in writing that we consider the reciprocity payment from Wisconsin to be preliminary pending resolution of this legal issue. Specifically, two analysts, Narciso Mindajao and Meredith Krejny, have determined that the reciprocity payment to be made in December 2000 is $42,610,000 based on the preliminary results of the 1995 benchmark study.

Thank you for your consideration in these matters.

Sincerely,

Matthew G. Smith
Commissioner of Revenue

cc: Governor Ventura

State of Wisconsin • DEPARTMENT OF REVENUE • OFFICE OF GENERAL COUNSEL

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October 24, 2000

Terese Mitchell, Director
Appeals & Legal Services Division
Minnesota Department of Revenue
Mail Station 2220
St. Paul, MN 55146-2220

Dear Ms. Mitchell:

Please accept this letter on behalf of Secretary Zeuske in response to your request to continue discussions regarding the methodology for calculating the reciprocity payment Wisconsin makes to Minnesota annually. Belatedly and most regrettably, this letter is also in response to Commissioner Mathew G. Smith's letter to Secretary Zeuske dated August 2, 2000. The Department has no record of receiving Commissioner Smith's letter. Thank you for your courtesy in faxing a copy to me on September 26.

As discussed over time, the Department rejects Minnesota's novel interpretation of the term, "net revenue loss," which appears in the statutes of both of our states. The law for both states clearly indicates that both states suffer a revenue loss from reciprocity. Minnesota foregoes taxes that would otherwise be paid by Wisconsin residents working in Minnesota and Wisconsin foregoes taxes that would otherwise be paid by Minnesota residents working in Wisconsin. "Net revenue loss" clearly refers to the difference between these amounts. Neither state's statute refers to another location for defining "net revenue loss," so there is no justification for looking outside of the sections in which this term is contained for a definition of the term. The Department's interpretation has been accepted by Minnesota until Ms. Carolyn Carlson raised this issue in connection with the 1995 rebenchmark study.

Ms Carlson asserts, but is unable to substantiate, that the reference in the 1980 supplement to the reciprocity agreement introduced an error into the calculation of the reciprocity payment for 1980. There is no substantiation of this assertion in the historical record. The record demonstrates that "net revenue loss," as early as 1975, was intended to be calculated as the difference in taxes foregone by both states. Further, the method for calculating the payment in 1980 is the same as the calculation of the final payment for every prior year and the same as the calculation of the payment for every subsequent year. Every single reciprocity payment made by Wisconsin to Minnesota has been equal to the taxes foregone by Minnesota on earnings in your state of Wisconsin residents less taxes foregone by Wisconsin on earnings in our state of Minnesota residents.

In looking at the history of reciprocity, the Department found that when the two states could not reach agreement on the amount of payment for tax year 1973, they agreed to arbitration. In its report, the arbitration board stated:

> "(The board) has made a preliminary finding that the Minnesota tax on income earned in 1973 within its borders by Wisconsin residents, had this income been fully reported to and taxed by Minnesota, would have exceeded by $5,916,000 the Wisconsin tax on income of Minnesota residents earned in Wisconsin had this income been fully reported to and taxed by Wisconsin."

Clearly, the arbitration board read the statutory provisions as defining "net revenue loss" as the difference between taxes foregone by Minnesota and taxes foregone by Wisconsin.

This report was based not only on the arbitration board's reading, but also upon submittals of both states indicating that this method of determining "net revenue loss" as the difference in taxes foregone by the two states was not in dispute. It was the method used by the Minnesota Department in its Research Report #118 and its subsequent "Report to the Board of Arbitrators," and by Wisconsin in its two submittals. The two states were in agreement on the method of calculating the reciprocity payment. Their difference was on whether to limit data used in this method to actual tax return and audit data, or to supplement it with findings from a statistical sample.

This methodology was again affirmed by Minnesota when the two states signed an agreement with the University of Michigan Survey Research Center, Institute for Social Research (ISR) In September of 1977, ISR issued a proposal for a "Compensation Payable under Minnesota-Wisconsin Tax Reciprocity Agreement" project, which defined compensation payable as:

> "the difference between (a) the amount of state individual income tax which in the absence of reciprocity Minnesota would have collected on the 1976 earnings of Wisconsin residents working in Minnesota, and (b) the amount of state individual income tax which in the absence of reciprocity Wisconsin would have collected on the 1976 earnings of Minnesota residents working in Wisconsin."

In December of 1977, the two states signed an agreement with ISR for a study that would determine "net revenue loss." Section II (k)(a) of that agreement indicates that ISR's report would contain: "Estimates of the taxes foregone by each state in 1976 as a result of reciprocity, the difference between these two being the net compensation payable by one state to the other."

That final report, published in September 1978 with the approval of both states, indicates that each state foregoes revenue when, because of reciprocity, it does not tax income earned within its borders by residents of the other state. The report calculates net revenue loss as the difference between taxes foregone by each state. This same methodology was used to calculate the payment in subsequent years. Rebenchmark studies in 1983 and 1995 have not changed the basic methodology.

In summary, the historical record clearly shows that the method for calculating "net revenue loss" was agreed to by our states at least as early as 1975, before the first payment was ever made, and that it was the method accepted by the board of arbitration. Both states agreed it should be the approach used by ISR in developing a methodology to calculate "net revenue loss" and in conducting a study that would determine that calculation It has been the method used in every year a payment has been made.

In Commissioner Smith's letter of August 2, Commissioner Smith suggests arbitration. Arbitration, as in the case of the initial payment, is permitted only when the two states cannot agree on the results of the calculation. The methodology underlying the calculation itself is codified in both states' statutes, and cannot be submitted to arbitration.

Commissioner Smith suggests, as an alternative to arbitration, that our two states seek legislative changes. This would change the computation for the sole purpose of increasing the payment by Wisconsin to Minnesota The Department cannot recommend such a change to our Governor or Legislature solely to increase the payment to Minnesota. There may be other criteria that would have to be evaluated as respects the substance of each state's tax code.

Wisconsin is quite adamant that it is complying with the reciprocity statute. The historical record clearly shows that the calculation of the Minnesota-Wisconsin reciprocity payment has been consistent through time. Both states have faithfully abided to the agreements We hope this relationship continues.

Sincerely,

John R. Evans

John R. Evans
Chief Counsel
(608) 266-2845

JRE:DC:SR:klt
Minn Reciprocity

pc: Cate Zeuske, Secretary of Revenue
Eng Braun, Administrator, Research and Analysis

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Tommy G. Thompson
Governor

Cate Zeuske
Secretary of Revenue

October 20, 2000

Mr. Matthew G. Smith, Commissioner
Minnesota Department of Revenue
Mail Station 7100
St. Paul, MN 55146-7100

Dear Commissioner ~~Smith~~ Matt

Thank you for your letter regarding the reciprocity agreement between our two states. I regret the delay in responding to your inquiry. Although we did not have a record of receiving your August letter, Therese Mitchell, Director of Appeals and Legal Services, was kind enough to fax a copy to the Department's Chief Counsel, John Evans.

Since Ms. Mitchell was in the process of contacting Chief Counsel John Evans to discuss the letter, it may be helpful to let them communicate regarding the agreement and the other suggestions in your letter. I have asked John Evans to start that process immediately

The Department is committed to the idea of reciprocity and to our agreement. It is important that the agreement be kept in place for all of our citizens Thank you.

Sincerely,

Cate

Cate Zeuske
Secretary of Revenue

CZ:tmb

pc: John Evans, Chief Counsel

Commissioner's Office St. Paul, Minnesota 55146-7100

August 2, 2000

Secretary Cate Zeuske
Wisconsin Department of Revenue
125 South Webster Street
P.O. Box 8933
Madison, Wisconsin 53708-8933

Dear Secretary Zeuske,

I am writing to continue our discussions concerning income tax reciprocity between our two states.

As you know, Minnesota and Wisconsin have had income tax reciprocity since 1968. The reimbursement provisions were added to the laws of both states in 1973 in response to a proposal by the governor of Minnesota to repeal reciprocity so that Minnesota could gain the revenues it was losing from reciprocity. Under the 1973 reimbursement provisions, taxpayers retained the convenience of reciprocity while Minnesota was compensated by Wisconsin for its revenue loss.

We believe that the calculation of the reciprocity payment has been erroneously determined for the past twenty years. The error was introduced in the 1980 Supplement to the Wisconsin-Minnesota Individual Income Tax Reciprocity Agreement, not in the document itself but instead by reference in the Supplement to the methodology outlined in a report prepared by the Institute for Social Research.

Details of this error are discussed in more detail in the attached Attachment A. The dispute centers around the question of whether the net revenue loss to Minnesota is net of what Wisconsin is losing or net of credits for taxes that would have been paid to the other state in the absence of a reciprocity agreement.

The current methodology does not fully compensate Minnesota for the losses attributable to the reciprocity agreement: If the reciprocity agreement was not in place the revenues gained by Minnesota would exceed the payments made by Wisconsin using the current methodology.

Since we feel that this result is contrary to law, the Minnesota Department of Revenue cannot in good faith continue with the current methodology. We still believe that the mediation provisions of the agreement were meant to be used to resolve this type of dispute. We would ask that you reconsider your opposition to the use of mediation.

Alternatively, I would propose exploring other options to resolve this matter. More specifically, I recommend that we look to propose legislative changes to our respective reciprocity statutes. The changes that I recommend are:

1. Define the term "net revenue loss" as the tax foregone by not taxing the residents of the other state less that amount of credit for taxes paid to the other state which would have been allowed by the state had there been no reciprocity agreement.

2. Limit the application of reciprocity to "wages" as defined for federal withholding tax purposes since the current "compensation for personal services" is much broader and subject to interpretation by both states and their taxpayers.

3. Codify the frequency and basic methodology of the benchmark studies done by our departments for calculating the payments, and a funding mechanism to pay for those studies.

4 Make the statutory language of our two reciprocity provisions more parallel than currently exists.

Given the complexities of the issues involved, coupled with the need to reach resolution, I propose that members of our respective staffs meet and discuss this matter. If you agree, please have someone contact my secretary, Jan Williams, at 651-296-3403 to make the necessary arrangements.

Sincerely,

Matthew G. Smith
Commissioner

cc: Dick Gebhart
Terese Mitchell
John Haugen
Carolyn Carlson

Attachment A: The Income Tax Reciprocity Reimbursement Statutes

The wording of the Minnesota and Wisconsin statutes providing for reciprocity reimbursement is consistent with the historical context and purpose of the reimbursement.

In 1973 Governor Anderson of Minnesota proposed to repeal income tax reciprocity as a means to raise revenue. Minnesota had reciprocity agreements with North Dakota and Wisconsin at that time. It was estimated that the repeal of reciprocity with North Dakota would be revenue neutral, but the repeal of reciprocity with Wisconsin would result in a *net revenue gain* for Minnesota. The estimated net revenue gain had two components:

- The tax on Wisconsin residents working in Minnesota; less
- The credit for tax paid to Wisconsin allowed to Minnesota residents.

The proposal to repeal reciprocity was seriously considered in the Minnesota Legislature. Wisconsin lawmakers and Governor Lucey thought that it was important to keep reciprocity. Both goals were met by laws enacted in the two states which provided that:

- Reciprocity would be retained.
- Wisconsin would pay to Minnesota the amount of its *net revenue loss* from reciprocity. The reimbursement payment would have the same fiscal impact on the Minnesota budget as the repeal of reciprocity, and the adopted budget reflected that.

Minnesota did not offer to pay to Wisconsin what it was losing due to reciprocity because Wisconsin has a *net revenue gain* from reciprocity. The fact that Wisconsin need not allow its residents a credit for tax paid to Minnesota has a much larger impact on Wisconsin's revenues than the amount of tax it loses from Minnesota residents.

Using the language from Minnesota Statutes, Section 290.081 and the numbers from the attached table:

Statute Language	*Implementation*
"For the purposes of clause (a), whenever the Wisconsin tax on Minnesota residents which would have been paid Wisconsin without clause (a) exceeds the Minnesota tax on Wisconsin residents which would have been paid Minnesota without clause (a), or vice versa,	The $44,943,000 that Wisconsin residents would pay to Minnesota is larger than the $13,299,000 Minnesota residents would pay to Wisconsin.
then the state with the net revenue loss resulting from clause (a) shall receive from the other state the amount of such loss."	Minnesota has a net revenue loss of $33,238,000 due to reciprocity; Wisconsin has a net gain of $30,989,000. Therefore Minnesota is to receive from Wisconsin the amount of such loss, or $33,238,000.

The wording in Wisconsin Statutes, Section 71.10 is very similar: "For purposes of income tax reciprocity reached with the state of Minnesota under s. 71.05 (2), whenever the income taxes on residents of one state which would have been paid to the 2nd state without reciprocity exceed the income taxes on residents of the 2nd state which would have been paid to the first state without reciprocity, the state with the net revenue loss shall receive from the other state the amount of the loss."

The language in both statutes is essentially the same: ". . . the state with the net revenue loss . . . shall receive from the other state the amount of such (the) loss."

The heart of the issue is, what does the term *net revenue loss* mean?

The wording of both statutes recognizes that only one state has a net revenue loss, and the payment is to be equal to that net loss. The issue addressed by the 1973 legislation was the impact of reciprocity on Minnesota revenues, not a settling up between the two states for their differences due to reciprocity. The language in the statutes does *not* say:

- Each state shall pay the other state the amount of the loss.
- One state shall pay the other state the difference between the two losses.

Why, then, does the calculation refer to "taxes foregone" by both states and subtracts one from the other to determine the payment amount?

When the reimbursement provisions were first enacted, the Minnesota tax was almost always higher than the Wisconsin tax, and the credit for tax paid to other states was roughly equal to the Wisconsin tax. Because the limitation of the credit would rarely be a factor, the Wisconsin tax on Minnesota residents was essentially the same as the credit. The credit was deemed to be equal to the Wisconsin tax in 1973, although it would have been more precise to actually test the limitation for each taxpayer.

Somewhere along the line the original purpose of the calculation was lost, which resulted in the terminology that is used in the 1976 and 1983 reports and in the 1980 supplement to the agreement between the two states. If the Minnesota tax were always higher than the Wisconsin tax, this point would make no difference in the amount of the payment.

However, the credit limitation does affect the amount of the payment. For many middle income taxpayers, the Wisconsin tax is higher than the Minnesota tax. Although this difference was first measured for the 1995 benchmark study, further investigation has revealed that the Wisconsin tax was higher than the Minnesota tax for many taxpayers for approximately twenty years.

Attachment B: Impact of Reciprocity on Minnesota and Wisconsin State Revenues

Based on the 1995 benchmark study, the following is the impact of reciprocity on the two states:

Revenues for the State of Minnesota

	Without Reciprocity	With Recip.	Difference Due to Reciprocity
MN tax on WI residents	$44,943,000	$0	($44,943,000)
Credit for WI tax paid by MN residents	(11,705,000)	$0	$11,705,000
Net revenue impact	$33,238,000	$0	**($33,238,000)**

Revenues for the State of Wisconsin

	Without Reciprocity	With Recip.	Difference Due To Reciprocity
WI tax on MN residents	$13,299,000	$0	($13,299,000)
Credit for MN tax paid by WI residents	(44,288,000)	$0	$44,288,000
Net revenue impact	($30,989,000)	$0	**$30,989,000**

According to the agreement and past practice, the payment for 1995 would be:

	Taxes forgone by Minnesota	$44,943,000
Less:	Taxes forgone by Wisconsin	-13,299,000
	Net compensation payable = Payment	**$31,644,000**

According to our interpretation of the law, the payment for 1995 should be:

	MN tax on WI residents	$44,943,000
Less:	Credit for WI tax paid by MN residents	-11,705,000
	Net revenue loss to MN = Payment	**$33,238,000**

Difference in payment for tax year 1995:

$33,238,000
-31,644,000
$1,594,000

Attachment C

Minnesota-Wisconsin Income Tax Reciprocity

Payments by Wisconsin to Minnesota
Depending Upon Resolution of How Payment Should be Measured

Tax Year	Initial Payment Date	Based on Agreement	Interpretation of the Law	Difference
1992	12/93	$26,644,000	$27,961,000	$1,317,000
1993	12/94	$26,786,000	$28,180,000	$1,394,000
1994	12/95	$28,177,000	$29,675,000	$1,498,000
1995	**12/96**	**$31,644,000**	**$33,238,000**	**$1,594,000**
1996	12/97	$37,625,000	$39,364,000	$1,739,000
1997	12/98	$40,576,000	$42,506,000	$1,930,000
1998	12/99	$46,277,000	$48,395,000	$2,118,000
Total		$237,729,000	$249,319,000	$11,590,000

Tax year 1995 benchmark study in bold.
Results of the study are used to determine the payment for that year, the three prior tax years, and subsequent years.

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December 28, 1999

Minnesota Department of Revenue
Mr. Richard Gebhart, Director
Tax Research Division
Mail Station 2230
St. Paul, MN 55146-2230

Dear Mr. Gebhart:

Thank you for your letter to Eng Braun of December 17, 1999. I am pleased that we have reached an agreement on calculation of the 1999 reciprocity payment.

Most respectfully, I am concerned about your reference to "legal issues" in the second paragraph of your letter. I presume that this refers to Ms. Carolyn Carlson's interpretive reading of the statute. As you know the Wisconsin Department of Revenue has reviewed Ms. Carlson's interpretation and concludes that it does not reflect Wisconsin or Minnesota statutes. Thus, the Department does not believe that there are any issues to resolve.

I felt it incumbent to advise you of this. I did not want you to feel that the Department agreed that there was some sort of discrepancy and was waiting to resolve it. The Department is adamant that the calculation is in accordance with the precise wording of the statute and with the original intent of the enactment. Further, the calculation for 1999 follows the same methodology used in all previous years.

Thank you for your courtesy and my best wishes to you for the holiday seasons.

Sincerely,

John R. Evans

John R. Evans
Chief Counsel
(608) 266-2845

JRE:skr:fab

L:JRE\gebhart 122.doc

cc: Secretary Cate Zeuske, Wisconsin DOR
Commissioner Matthew Smith, Minnesota DOR
Eng Braun
Dennis Collier

MINNESOTA Department of Revenue
Tax Research Division

December 17, 1999

Yeang-Eng Braun, Administrator
Wisconsin Department of Revenue
Division of Research and Analysis
123 South Webster Street
P.O. Box 8933
Madison, Wisconsin 53708-8933

Dear Eng:

Dennis Collier and Narciso Mindajao have reached agreement on the calculation of the December 1999 income tax reciprocity reimbursement by the State of Wisconsin to the State of Minnesota. The payment to be made on December 27, 1999, is $46,475,000.

The payment is based on the preliminary results of the 1995 benchmark study. The results of the study cannot be considered final until the legal issues concerning the payment are resolved

The last step of the calculation and the information needed to make the wire transfer are attached.

Please call me if you have any questions.

Sincerely,

Rick

Richard Gebhart, Director
Minnesota Department of Revenue
Tax Research Division
Mail Station 2230
St. Paul, Minnesota 55146-2230
(651) 296-3425

Attachments

cc: Dennis Collier
Narciso Mindajao
Rod Hoheisel
Carolyn Carlson

Computation of Reciprocity Payment for December 1999
Based on Ratios from the 1998 Rebenchmark Study Using 1995 Data

	1997(99)	1998(99)
Payment Due Based on 1999 Calculations	$40,773,000	$46,277,000
Payment Made Previous	40,575,000	0
Balance due	198,000	
December 1999 Payment		**$46,475,000**

Narciso M. Mindajao
Senior Research Analysis Specialist
Minnesota Department of Revenue
TAX RESEARCH DIVISION
Date prepared: December 16, 1999
file: h:\users\nmindaja\excel5\recip94.xls, sheet recip99

Appendix D

Minnesota and Wisconsin Statutes

Minnesota Statutes, Section 290.081 Income of nonresidents, reciprocity.

(a) The compensation received for the performance of personal or professional services within this state by an individual whose residence, place of abode, and place customarily returned to at least once a month is in another state, shall be excluded from gross income to the extent such compensation is subject to an income tax imposed by the state of residence; provided that such state allows a similar exclusion of compensation received by residents of Minnesota for services performed therein.

(b) When it is deemed to be in the best interests of the people of this state, the commissioner may determine that the provisions of clause (a) shall not apply. As long as the provisions of clause (a) apply between Minnesota and Wisconsin, the provisions of clause (a) shall apply to any individual who is domiciled in Wisconsin.

(c) For the purposes of clause (a), whenever the Wisconsin tax on Minnesota residents which would have been paid Wisconsin without clause (a) exceeds the Minnesota tax on Wisconsin residents which would have been paid Minnesota without clause (a), or vice versa, then the state with the net revenue loss resulting from clause (a) shall receive from the other state the amount of such loss. This provision shall be effective for all years beginning after December 31, 1972. The data used for computing the loss to either state shall be determined on or before September 30 of the year following the close of the previous calendar year.

Interest shall be payable on all delinquent balances relating to taxable years beginning after December 31, 1977. The commissioner of revenue is authorized to enter into agreements with the state of Wisconsin specifying the reciprocity payment due date, conditions constituting delinquency, interest rates, and a method for computing interest due on any delinquent amounts.

If an agreement cannot be reached as to the amount of the loss, the commissioner of revenue and the taxing official of the state of Wisconsin shall each appoint a member of a board of arbitration and these members shall appoint the third member of the board. The board shall select one of its members as chair. Such board may administer oaths, take testimony, subpoena witnesses, and require their attendance, require the production of books, papers and documents, and hold hearings at such places as are deemed necessary. The board shall then make a determination as to the amount to be paid the other state which determination shall be final and conclusive.

The commissioner may furnish copies of returns, reports, or other information to the taxing official of the state of Wisconsin, a member of the board of arbitration, or a consultant under joint contract with the states of Minnesota and Wisconsin for the purpose of making a determination as to the amount to be paid the other state under the provisions of this section. Prior to the release of any information under the provisions of this section, the person to whom the information is to be released shall sign an agreement which provides that the person will protect the confidentiality of the returns and information revealed thereby to the extent that it is protected under the laws of the state of Minnesota.

HIST: 1941 c 429; 1943 c 656 s 19; 1959 c 10 s 1; 1961 c 213 art 3 s 1; 1967 c 42 s 1; 1973 c 582 s 3; 1973 c 650 art 6 s 1; 1977 c 387 s 1; 1977 c 423 art 1 s 7; 1979 c 303 art 1 s 13; 1980 c 607 art 1 s 9; 1981 c 178 s 25; 1982 c 523 art 1 s 12; art 28 s 1; 1983 c 15 s 11; 1985 c 248 s 70; 1986 c 444; 1987 c 268 art 1 s 48; 1988 c 719 art 1 s 11; 1989 c 184 art 2 s 17

Wisconsin Statutes, Section 71.05 (2) Nonresident Reciprocity.

All payments received by natural persons domiciled outside Wisconsin who derive income from the performance of personal services in Wisconsin shall be excluded from Wisconsin gross income to the extent that it is subjected to an income tax imposed by the state of domicile; provided that the law of the state of domicile allows a similar exclusion of income from personal services earned in such state by natural persons domiciled in Wisconsin, or a credit against the tax imposed by such state on such income equal to the Wisconsin tax on such income.

Wisconsin Statutes, Section 71.10 (7) Minnesota Income Tax Reciprocity.

(a) For purposes of income tax reciprocity reached with the state of Minnesota under s. 71.05(2), whenever the income taxes on residents of one state which would have been paid to the 2nd state without reciprocity exceed the income taxes on residents of the 2nd state which would have been paid to the first state without reciprocity, the state with the net revenue loss shall receive from the other state the amount of the loss. Interest shall be payable on all delinquent balances relating to taxable years beginning after December 31, 1977. The secretary of revenue may enter into agreements with the state of Minnesota specifying the reciprocity payment due date, conditions constituting delinquency, interest rates and the method of computing interest due on any delinquent amounts.

(b) The data used for computing the loss to either state shall be determined by the respective departments of revenue of both states on or before November 1 of the year following the close of the previous calendar year. If an agreement cannot be reached as to the amount of the loss, the secretary of revenue of this state and the commissioner of taxation of the state of Minnesota shall each appoint a member of a board of arbitration and these members shall appoint a 3rd member of the board. The board shall select one of its members as chairman. The board may administer oaths, take testimony, subpoena witnesses and require their attendance, require the production of books, papers and documents and hold hearings at such places as it deems necessary. The board shall then make a determination as to the amount to be paid the other state which shall be conclusive. This state shall pay no more than one-half of the cost of such arbitration.