

PERSONAL INCOME TAX

ISSUE

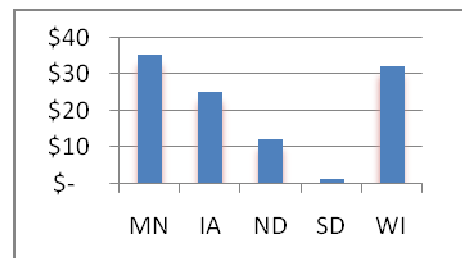
Are further personal income tax reductions needed to make Minnesota more attractive to operate a business? Should the state create a new income tax bracket for high wage-earners?

POLICY

The personal income tax cuts of 1999 and 2000 reduced state revenues by more than \$1 billion per year; however, the tax is still a competitive problem for Minnesota. In 2006 Minnesota had the fifth highest personal income taxes per \$1,000 of income. None of our surrounding states was in the top 10 states nationally. To the extent that further personal income tax cuts are made, they should focus on the following:

- **Capital gains.** Minnesota should reduce taxes on individual capital gains by either taxing them at a rate lower than ordinary income or enacting a capital gains exclusion. (The average and median top capital gains tax rate in the 40 states plus the District of Columbia that tax capital gains is about 6 percent. Ten states do not tax capital gains.)
- **Rates.** Minnesota should continue to reduce personal income tax rates across the board.

2006 Personal Income Tax per



Moreover, PIM opposes the creation of a new fourth income tax bracket for high wage-earners. A new fourth bracket would disproportionately and adversely affect Minnesota employers that flow their business income through their personal income tax returns. (92% of Minnesota business owners flow their business income through their personal income tax returns.)

BUSINESS IMPACT

Reducing individual capital gain taxes will help increase the formation of venture capital so small firms are better able to acquire the financing needed to grow. Capital generally flows to places where it can earn the greatest return. Reducing the taxation of capital gains will increase that return, resulting in more capital flowing into Minnesota.

Reducing personal income tax rates across the board will make the state more attractive for small businesses to operate and make it easier for firms to recruit high-skilled workers. The vast majority of Minnesota's businesses, including its smallest and newest (sole proprietors, partnerships and S-corporations), flow their business income through a personal rather than a corporate income tax return. Even though the Legislature passed consecutive income tax rate reductions in 1999 and 2000, Minnesota's personal income tax is still a competitive issue. The state's national ranking (personal income tax per \$1,000 income) was still the fifth highest in the country in FY 2006., it was the fourth highest in the country in FY 1998.

In 2007, the Minnesota House proposed the creation of a new fourth bracket at 9 percent for married-joint filers at \$400,000 of income (\$226,000 for single filers). This new bracket would have affected 9,500 Minnesota residents with small business income, and consequently increased their taxes by \$86 million per year. Similarly, in 2007, the Minnesota Senate proposed creating a new fourth bracket at 9.7 per cent for married-joint filers at \$250,000 of income (\$141,000 for single filers). This proposal would have negatively affected 29,800 Minnesota residents with small business income and raised their taxes by \$183 million per year. The House proposal would have elevated Minnesota to the third highest income tax rate in the nation. The Senate proposal would have similarly elevated Minnesota to the highest income tax rate in the country.

Creation of a fourth income tax bracket for high wage-earners would place Minnesota businesses at a disadvantage by slowing short-term growth, while eating into long-term investment capital. Raising the cost of creating higher skilled and more highly compensated jobs in Minnesota sends the wrong message to employers. A higher tax rate would make it more difficult and more expensive for employers to create those kinds of jobs here and encourage employers to create those jobs elsewhere.