INDIVIDUAL INCOME TAX
Conform to Federal Standard Deduction for Married Filers, AMT Modifications, New Top Rate & Bracket, Repeal Exclusion of Deferred Compensation for Non Residents, and Federal Update

March 30, 2006

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 3550 (Pogemiller), **As Proposed to be Amended (SCS3550A-2)**

	Fund Impact			
	F.Y. 2006	**F.Y. 2007**	**F.Y. 2008**	**F.Y. 2009**
		(000's)		
Federal Standard Deduction for Married Filers				
Tax Years 2006 - 2008	$0	($28,700)	($14,800)	($6,500)
Retroactive to Tax Year 2005	$0	($33,200)	$0	$0
Increase AMT Exemption Amounts and Thresholds (1/1/06)	$0	($28,500)	($33,100)	($37,600)
Dependent Exemption from AMTI (1/1/06)	$0	($12,500)	($14,800)	($16,600)
New Top Rate of **8.15%** & Bracket (1/1/06)	$0	$65,400	$54,900	$56,400
Interaction with AMT & Rate Increase	$0	$11,800	$14,100	$15,900
Repeal Exclusion of Deferred Compensation for Nonresidents (1/1/06)	$0	$2,100	$2,200	$2,400
Federal Update				
The Energy Tax Incentives Act of 2005				
Individual Income Tax	($560)	($60)	$0	$40
Corporate Franchise Tax	($40)	($1,900)	($3,000)	($3,740)
Total	($600)	($1,960)	($3,000)	($3,700)
The Katrina Emergency Tax Relief Act of 2005				
Individual Income Tax	($3,885)	$90	$65	$0
Corporate Franchise Tax	($320)	($120)	($10)	$0
Total	($4,205)	($30)	$55	$0
The Gulf Opportunity Zone Act of 2005				
Individual Income Tax	($85)	($140)	($50)	$10
Corporate Franchise Tax	($300)	($410)	($200)	($20)
Total	($385)	($550)	($250)	($10)
General Fund Total	($5,190)	($26,140)	$5,305	$10,290

EXPLANATION OF THE BI LL

Conform to Federal Standard Deduction for Married Filers

The proposal is to conform to the federal change in the standard deduction contained in the Working Families Tax Relief Act of 2004. This provision defines the standard deduction for a married couple filing a joint return to be equal to twice the amount of the standard deduction for single filers, and the standard deduction for married persons filing separate returns to be equal to that for single filers. These definitions would apply beginning in 2006 instead of being phased in, as current law provides.

	Standard Deduction: Married-Joint as a Percent of Single	
	Current Law	Proposed
Tax Year 2006	184%	200%
Tax Year 2007	187%	200%
Tax Year 2008	190%	200%
Tax Year 2009	200%	200%

Number of Taxpayers: About 419,300 married taxpayers in 2006 experience a tax decrease of $74.

Conform to Federal Standard Deduction for Married Filers Retroactive to Tax Year 2005

The proposal requires the Department of Revenue to retroactively adjust the 2005 tax returns for those married-joint standard deduction filers who added back $1,300 to federal taxable income ($650 for married-separate), and for married itemizers who would have a smaller add-back of state income taxes deducted on their federal tax returns. Those taxpayers whose marriage credit was greater owing to the difference between the federal and state deductions are held harmless

Number of Taxpayers: About 441,000 married taxpayers in 2005 experience a tax decrease of $75.

Alternative Minimum Tax (AMT) Exemption Amounts

For tax year 2006 the proposal would increase the AMT exemption from $40,000 to $67,250 for married joint filers, from $20,000 to $33,625 for married separate filers, and from $30,000 to $50,435 for single and head of household filers. In addition, the proposal increases the phase-out threshold from $150,000 to $252,160 for married joint filers, from $75,000 to $126,080 for married separate filers, and from $112,500 to $189,120 for single and head of household filers. The exemption amounts and phase-out thresholds are adjusted for inflation starting with tax year 2007. The following tables show exemption and phase-out threshold amounts under current law, the proposal for 2006, and adjusted for inflation for tax years 2007 and 2008.

Current Law

Filing Status	Exemption	Phase-Out Begins	Phase-Out Ends
Married Joint	$40,000	$150,000	$310,000
Married Separate	$20,000	$75,000	$155,000
Single	$30,000	$112,500	$232,500
Head of Household	$30,000	$112,500	$232,500

Proposal
Tax Year 2006

Filing Status	Exemption	Phase-Out Begins	Phase-Out Ends
Married Joint	$67,250	$252,160	$521,160
Married Separate	$33,625	$126,080	$260,580
Single	$50,435	$189,120	$390,860
Head of Household	$50,435	$189,120	$390,860

Proposal
Tax Year 2007

Filing Status	Exemption	Phase-Out Begins	Phase-Out Ends
Married Joint	$69,250	$259,670	$536,670
Married Separate	$34,630	$129,830	$268,350
Single	$51,940	$194,750	$402,510
Head of Household	$51,940	$194,750	$402,510

Proposal
Tax Year 2008

Filing Status	Exemption	Phase-Out Begins	Phase-Out Ends
Married Joint	$70,470	$264,240	$546,120
Married Separate	$35,240	$132,120	$273,080
Single	$52,850	$198,180	$409,580
Head of Household	$52,850	$198,180	$409,580

Number of Taxpayers: For tax year 2006, an estimated 44,700 returns would receive a reduction in the Minnesota alternative minimum tax of an average of $640 per tax return, including 41,900 returns which would no longer be subject to the AMT.

Dependent Exemption Deduction from Alternative Minimum Taxable Income (AMTI)
This proposal would allow a dependent exemption deduction from AMTI equal to the federal dependent exemption for each dependent starting in tax year 2006.

Number of Taxpayers: For tax year 2006, an estimated 34,800 returns would receive a reduction in the Minnesota alternative minimum tax of an average of $360 per tax return, including 22,000 returns which would no longer be subject to the AMT.

All AMT Components together

This includes all the above AMT components combined. It includes the proposed exemption and phase-out levels and the dependent exemption from AMTI.

Number of Taxpayers: For tax year 2006, an estimated 44,800 returns would receive a reduction in the Minnesota alternative minimum tax of an average of $654 per tax return, including 42,600 returns which would no longer be subject to the AMT.

Individual Income Tax Rates and Brackets

The proposal adds a new top bracket at a rate of 8.15% starting in tax year 2006. The top bracket starts at $270,000 for married-joint filers $135,000 for married-separate filers, $180,000 for single filers, and $229,500 for head-of-household filers. The brackets are adjusted yearly for inflation with tax year 2006 set as the new base. These changes are presented in the following tables:

	Tax Year 2006							
	Current Law				**Proposed Law**			
Married Joint								
	5.35%	$ 0	-	$29,980	5.35%	$ 0	-	$29,980
	7.05	29,981	-	119,100	7.05	29,981	-	119,100
	7.85	Over		119,100	7.85	119,101	-	270,000
					8.15	Over		270,000
Married Separate								
	5.35%	$ 0	-	$14,990	5.35%	$ 0	-	$14,990
	7.05	14,891	-	59,550	7.05	14,991	-	59,550
	7.85	Over		59,550	7.85	59,551	-	135,000
					8.15	Over		135,000
Single								
	5.35%	$ 0	-	$20,510	5.35%	$ 0	-	$20,510
	7.05	20,511	-	67,360	7.05	20,511	-	67,360
	7.85	Over		67,360	7.85	67,361	-	180,000
					8.15	Over		180,000
Head of Household								
	5.35%	$ 0	-	$25,250	5.35%	$ 0	-	$25,250
	7.05	25,251	-	101,450	7.05	25,251	-	101,450
	7.85	Over		101,450	7.85	101,451		229,500
					8.15	Over		229,500

Number of Taxpayers: Approximately 41,900 taxpayers would receive an average tax increase of $1,162 in tax year 2006.

Repeal Exclusion of Deferred Compensation for Nonresidents

Under current law, there is an exemption from the individual income tax for wage income that was earned while the taxpayer was a resident but is received in a year that the taxpayer was a nonresident for the full year. The bill would eliminate this exemption.

REVENUE ANALYSIS DETAIL

Conformity to Federal Standard Deduction for Married Filers

- Simulation results are obtained using the House Income Tax Simulation (HITS 5.4) model. The simulations assume the same economic conditions used by the Minnesota Department of Finance for the forecast published in February 2006. The model uses a stratified sample of 2003 individual income tax returns compiled by the Minnesota Department of Revenue.
- For conforming to the federal standard deduction component of the proposal, all of tax year 2006 was allocated to FY 2007, and tax years 2007 and 2008 were allocated 50/50 to fiscal years.
- For the retroactive conformity to the federal standard deduction to tax year 2005, all the revenue impacts were allocated to fiscal year 2007 since costs would be paid out of the tax relief fund in fiscal year 2007. The HITS model was used to model the revenue impact for those married-joint standard deduction filers who added back $1,300 to federal taxable income ($650 for married-separate), and for married itemizers who would have a smaller add-back of state income taxes deducted on their federal tax returns.

Alternative Minimum Tax Modifications

- Simulation results are obtained using the House Income Tax Simulation (HITS 5.4) model.
- Tax year impact is allocated to the following fiscal year.

*New Top Rate of **8.15%** & Bracket*

- Simulation results are obtained using the House Income Tax Simulation (HITS 5.4) model.
- In allocating the tax year impacts to fiscal years, a standard rule of thumb formula was applied.

Repeal Exclusion of Deferred Compensation for Nonresidents

- The estimates are based on information that was developed following the Minnesota Supreme Court decision in *Victor C. Benda v. James Girard in His Capacity as Commissioner of Revenue, et al*.
- Amended returns filed in response to the court case were the primary source of information, supplemented with a sample of 1997 individual income tax returns of nonresidents.
- Annual growth of 6% was assumed.
- Tax year impact was allocated to the following fiscal year.

Federal Update: The Energy Tax Incentives Act of 2005, The Katrina Emergency Tax Relief Act of 2005, The Gulf Opportunity Zone Act of 2005

- The estimates are based on the estimates for the federal legislation prepared by the Joint Committee on Taxation.
- If both the individual income and corporate franchise taxes would be affected, the federal estimates were divided between the two taxes.
- The federal estimates were apportioned to Minnesota based on a measure appropriate to the provision. For the Katrina Emergency Tax Relief and the Gulf Opportunity Zone Acts, the estimates were further adjusted to reflect the extent to which Minnesota taxpayers would likely be affected by the provision. No adjustment was made for provisions not limited to the hurricane disaster areas: suspending the limitations for qualified charitable contributions by individuals and extending the enhanced deduction for the contributions of food inventory and book inventory.
- Federal and state marginal rates were applied, and the estimates were converted from federal fiscal years to state fiscal years.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy

sf3550_1/mjr