Tax Incidence Analysis, as Requested by the Chair of the House Tax Committee

Prepared by the Tax Research Division, Minnesota Department of Revenue

November 1, 2012

HF 2480 (Winkler), Article 1, Sections 8 & 9

As introduced in the 2012 Legislative Session

(There was no hearing on this bill.)

Article 1, Sections 8 & 9 would change Minnesota's corporate apportionment formula.

- The share of a multistate corporation's total income that is taxed in Minnesota is defined by Minnesota's corporate apportionment formula. The share taxable in Minnesota is based on a weighted average of the shares of the corporation's (1) sales, (2) property, and (3) payroll that are located in Minnesota.

  Under current law – for tax year 2013 – the Minnesota share of sales is weighted 96% and the Minnesota shares of property and payroll are each weighted 2%. Starting in tax year 2014, under current law, the weight on the Minnesota share of sales will increase to 100%.

  The proposal would repeal replace current law apportionment it with an equal-weight apportionment formula – 1/3 sales, 1/3 property, and 1/3 payroll.

- The move to an equal-weights apportionment formula would have no effect on the taxes paid by a "100% Minnesota" corporation. All of its sales, property, and payroll are located in Minnesota, so all of its income is subject to tax regardless of the apportionment formula.

  The change would *increase* tax for corporations whose payroll and property are more concentrated in Minnesota than their sales. For example, a manufacturer with all of its production in Minnesota and only 2% of its sales in Minnesota would see an increase in tax when the production factors (payroll and property) are weighted more heavily.

  The change would *reduce* tax for corporations that have a higher share of sales in Minnesota than the share of their payroll and property that is located in Minnesota.

Impact of Proposed Law Change on Corporate Tax Liability

- The impact of the proposed change is modeled for the 2013 tax year, based on corporate tax returns filed in 2010 and the February 2012 economic forecast.

- The proposal is estimated to increase tax year 2013 liability by $252.8 million. The industries with largest tax increases include manufacturing ($149 million), retail ($48 million), banking ($26 million), and transportation and warehousing ($16 million). Industries that would see a net *reduction* in tax include telecommunications (-$10 million), professional, scientific and technical services (-$2 million), utilities (-$1 million), and accommodations and food service (-$0.2 million).

- Although net tax liability would rise by $252.8 million, the number of corporations that would pay *less* tax exceeds the number who would pay *more* tax. Total tax reductions for corporations that would pay less tax are estimated at $178 million, but this is more than offset by the tax increases for those who would pay more ($431 million).

- These dollar estimates make no adjustment for behavioral changes in response to the change in the apportionment formula. Many states have moved from equal-weight apportionment to (or toward) 100% sales apportionment in the belief that it provides an incentive for businesses to move (or keep) production facilities in the state. Although the estimated impact on revenue is not adjusted for behavioral changes, the incidence analysis below does assume that behavioral changes will reduce wages for Minnesota workers.

Incidence of the Net Increase in Corporate Tax

- The corporate tax is modeled in the Minnesota Tax Incidence Study as a tax on capital. The incidence analysis is "long-term" in the sense that it estimates the burden after businesses have had time to fully adjust to the proposed change in tax. Because capital is mobile and can move across state borders, some of the burden of higher corporate taxes is shifted to consumers in higher prices and some is shifted to workers in lower wages. The extent to which the tax is shifted depends on the nature of the business. Some types of business (such as retail, accommodations, and consumer services) are more tied to a location than others (such as manufacturing). Some businesses compete largely in a local market while others compete in a national or international market. The business tax incidence model takes these business characteristics into account, as explained on pages 90-101 of the *2011 Minnesota Tax Incidence Study*.

- The *Tax Incidence Study* compares Minnesota's *existing* corporate tax to the existing corporate taxes in other states. In effect, it assumes that all state corporate taxes are imposed simultaneously. In contrast, this analysis of the incidence of a *change* in Minnesota tax assumes that the Minnesota tax change occurs in isolation, while all other states maintain their current tax structure. As a result, all of the tax increase is a change in the "Minnesota tax differential". This has a substantial effect on the incidence analysis. For example, when only Minnesota taxes increase, it is proper to adjust for the fact that Minnesota's tax is deductible in calculating the US corporate tax. This means that a portion of the Minnesota tax increase is borne by the federal government in reduced federal tax revenue. This "federal tax offset" means that 35% of the increased corporate tax burden is effectively exported to the federal government. (See a more complete discussion on pages 61-62 of the *2011 Minnesota Tax Incidence Study*.)

- The business incidence model estimates that the $252.8 million net tax increase will be borne as follows:
    - 40.3% will be borne by nonresidents (including the federal government's loss in revenue)
    - 59.7% will be borne by Minnesota residents.
        - 24.8% will be borne by Minnesota consumers in higher prices
        - 34.6% will be borne by Minnesota labor in lower wages
        - 0.3% will be borne by Minnesota investors in lower profits

The high share borne by workers is mostly due to the relatively large share of the tax increase that would fall on manufacturing. The low share borne by Minnesota investors is explained by the fact that most corporate stock in the affected corporations is owned by nonresidents.

Revenue would rise by $252.8 million but the burden on Minnesota residents would rise by less, at $150.9 million. Roughly $100 million of the burden would be "exported" to nonresidents.

Results by Population Decile: Minnesota Taxes

- Tax burdens would rise by an average of 0.08% of income. Tax increases as a percent of income exceed this average in each of the bottom 9 deciles (though this is not obvious in the table due to rounding). Below-average increases as a percent of income would occur only in the 10th decile, and increases are even smaller for the top 5% and top 1%.

2013 Population Decile	Income Range	Percent of All Households	Tax Burden as Percent of Income		
			Current Law	Proposed Law	**Change**
First	$ 11,298 & under	10%	30.46%	30.66%	**0.20%**
Second	$ 11,299 to $ 18,732	10%	12.10%	12.22%	**0.12%**
Third	$ 18,733 to $ 26,788	10%	11.02%	11.12%	**0.10%**
Fourth	$ 26,789 to $ 35,561	10%	11.55%	11.65%	**0.10%**
Fifth	$ 35,562 to $ 46,044	10%	12.06%	12.15%	**0.09%**
Sixth	$ 46,045 to $ 59,437	10%	12.10%	12.19%	**0.09%**
Seventh	$ 59,438 to $ 76,276	10%	12.07%	12.15%	**0.08%**
Eighth	$ 76,277 to $ 99,386	10%	12.30%	12.38%	**0.08%**
Ninth	$ 99,387 to $ 142,225	10%	11.89%	11.97%	**0.08%**
Tenth	$ 142,226 & over	10%	10.36%	10.42%	**0.06%**
ALL		100%	11.47%	11.55%	**0.08%**
Top 5%	$ 200,907 & over	5%	10.07%	10.12%	**0.05%**
Top 1%	$ 472,626 & over	1%	9.68%	9.71%	**0.04%**

- The "population-decile" Suits index for all taxes combined would move a bit further from zero, falling from -0.0467 to -0.0472. Note that it still rounds to the -0.047 reported for current law for 2013 in the *2011 Minnesota Tax Incidence Study.* Although the additional corporate tax is regressive (with a population-decile Suits index of -0.123), the dollar increase in the tax burden is small so the overall Suits index moves little. The proposal would increase the regressivity of the overall tax system, though, as would be expected given the pattern of changes by decile. (Note: Full-sample Suits index is not available.)

Comments on the Context of the Proposal

- **HF 2480 would have made many other changes to the corporate tax as well, all of which would have increased corporate revenue.** Only the change in the apportionment formula for the corporate franchise tax is included in this analysis.
- **The revenue raised by HF 2480 would all have been used to pay back the school shift (until the aid payments reached 90 percent).** Any impact this would have on school districts or school property tax levies is not included in this analysis.

Appendix Table

Tax Incidence Analysis
HF 2480 (2012 Session), Article 1, Sections 8 and 9
Equal Weights Corporate Apportionment

(Dollars in $1000s)

2013 Population Decile	Income Range	Number of Housholds	Current Law Total State and Local Tax Burden	**Total Net Change in Tax Burden**	Proposed Law Total State and Local Tax Burden
First	$ 11,298 & under	263,199	$ 530,646	**$ 3,497**	$ 534,143
Second	$ 11,299 to $ 18,732	263,199	479,849	**4,704**	484,553
Third	$ 18,733 to $ 26,788	263,199	656,857	**6,217**	663,074
Fourth	$ 26,789 to $ 35,561	263,199	945,059	**8,067**	953,126
Fifth	$ 35,562 to $ 46,044	263,199	1,285,863	**9,766**	1,295,629
Sixth	$ 46,045 to $ 59,437	263,199	1,673,264	**11,953**	1,685,217
Seventh	$ 59,438 to $ 76,276	263,199	2,146,415	**14,766**	2,161,181
Eighth	$ 76,277 to $ 99,386	263,199	2,821,394	**19,052**	2,840,446
Ninth	$ 99,387 to $ 142,225	263,199	3,672,422	**25,086**	3,697,508
Tenth	$ 142,226 & over	263,199	8,516,676	**47,800**	8,564,476
ALL MINNESOTA HOUSEHOLDS		2,631,989	$ 22,728,445	**150,908**	$ 22,879,353
Top 5%	$ 200,907 & over	131,652	$ 6,076,987	**31,101**	$ 6,108,088
Top 1%	$ 472,626 & over	26,332	$ 2,992,407	**12,024**	$ 3,004,431

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Technical Addendum

A. Year of Analysis

- The analysis is based on tax year 2013 because that is the latest year included in the *2011 Minnesota Tax Incidence Study.* In the current law 2013 apportionment formula, sales are weighted 96% and payroll and property are weighted 2% each. The analysis shows the impact of moving from 96%/2%/2% to 33.33%/33.33%/33.33%.
- In 2014, when the current law apportionment is 100% sales, forecast revenue is 6% higher and the revenue gain from equal-weights apportionment would be 9% higher (at $275.7 million). This suggests that the 2013 numbers are roughly 3% lower because they are comparing 96% sales apportionment to equal weights rather than 100% sales apportionment.

B. Estimating the Incidence of CHANGES in Business Taxes ("Incremental Incidence")

- As explained on pages 61-62 of the Tax Incidence Study, the incidence of a change in the level of business taxes ("incremental incidence") will differ from the average incidence of existing business taxes ("average incidence"). Average incidence divides an existing business tax into three parts – the national average tax on all capital, the sector differential, and the Minnesota differential. In contrast, a change in the level of a business tax is all treated as a change in the Minnesota differential.
- If the level of Minnesota business taxes changes, this will generally change the amount of *federal tax* paid by the business – either the federal corporate income tax or the federal individual income tax (for flow-through businesses). For a corporation paying federal tax at the 35% rate, each additional $1000 in Minnesota tax will reduce the federal tax burden by $350. So $350 of the $1000 of Minnesota tax burden is borne by the federal government in foregone tax revenue. The burden of the remaining $650 in tax may be shifted to consumers in higher prices or to workers in lower compensation – or it may reduce the after-tax income of the business owner. [1]
- The extent to which the tax burden will be shifted to consumers or workers will depend on the nature of the market. Minnesota tax changes are most likely to result in price changes if the market is local and close competitors see the same change in tax. Businesses selling in national or international markets are much less likely to shift the added cost to consumers by raising prices (or reduce their price in response to a tax cut). *As in the incidence study, the incidence results assume the market has time to fully adjust to any tax changes.*
- The incidence of the business tax changes in the bill (as modeled here) is as follows:

  Corporate tax: 34.6% shifted to workers, 24.8% shifted to consumers, 0.3% borne by Minnesota investors, and 40.3 percent borne by nonresidents (including both the losses to stockholders residing in other states and the reduction in federal tax revenue).

[1] For corporate tax, the analysis assumes a federal tax rate of 35% because corporations paying state tax are assumed to also be paying federal tax.