Program: Individual Income Tax
Change Item: New Bracket and Marginal Rate for Higher Incomes

Fiscal Impact ($000s)	FY 2012	FY 2013	FY 2014	FY 2015
General Fund				
Expenditures	0	0	0	0
Revenues	$1,003,900	$886,400	$862,800	$931,100
Other Fund				
Expenditures	0	0	0	0
Revenues	0	0	0	0
Net Fiscal Impact	$(1,003,900)	$(886,400)	$(862,800)	$(931,100)

Recommendation

The Governor recommends creating a new 4th bracket for upper incomes at a marginal income tax rate 10.95%. This change will generate $1.890 billion of additional revenue for the General Fund in FY 2012-13. The new bracket would begin at $150,000 taxable income for joint filers, $130,000 for head-of-household filers, and $85,000 for single filers. The new bracket would be effective beginning with tax year 2011. It would not be indexed for inflation.

Rationale

The Department of Revenue's Tax Incidence Study illustrates that the state and local tax system in Minnesota is regressive. In particular, the top ten percent of households measured by annual income pay a smaller share of their income to support state and local services than do households at lower incomes. Among the major tax types, the income tax is the only progressive tax and the property tax is the most regressive. The new marginal rate on higher income households reflects the Governor's priorities to increase state revenues to support general fund programs in a way that makes the overall tax system more progressive.

As shown in the table below, the tax burden as a percent of income is less for those with highest incomes than for the rest of the population. This pattern has become more pronounced in recent years.

Portion of the Population	Total Income	State and Local Tax Burden as Percent of Income (projected to 2011)
Lowest 90 percent	Less than $137,000	12.3%
Top 10 percent	$137,000 or more	10.1%
Top 5 percent	$194,000 or more	9.7%
Top 1 percent	$481,000 or more	8.8%

The additional tax bracket will raise taxes on 5.5 percent of those who file tax returns (9.6 percent of married filers and 2.3 percent of single filers). Those with incomes over $500,000 (0.8% of total filers) would pay 70 percent of the additional tax. The percentage of taxpayers affected would be even smaller if non-filers were included.

Date: March 10, 2011

To: Senator Ortman

From: Beth Kadoun, Senate Tax Committee Administrator Beth

Re: Governor Dayton's proposal on 4th tier and lack of indexing 4th tier for inflation

As stated in page 6 of the Governor's State Taxes and Local Aids and Credit budget proposal. The Governor recommends creating a new 4th bracket at an income tax rate of 10.95%. The new bracket would begin at $150,000 taxable income for joint filers, $85,000 for single filers. As indicated in the Governor's budget document, **"the new bracket would not be indexed for inflation".**

This lack of indexing will cause bracket creep, where more and more taxpayers over time will be pushed into the higher tax brackets due to the inflation factor. The result is an increase in income taxes for those taxpayers but without any increase in real purchasing power. Under current law, the current individual income tax brackets are indexed for inflation. Attached is a recent press release from Minnesota Department of Revenue that explains the current brackets and indexing that occurs annually. As is stated in the press release:

> "State law requires the department to adjust the brackets to compensate for increases in inflation. Expanding the brackets prevents taxpayers from being pushed into higher income tax brackets solely because of inflationary increases in their income. Since tax year 2000, Minnesota's income tax brackets have expanded by more than 30 percent as a result of inflation."

A run by Senate non-partisan fiscal staff is attached that shows the current 3rd bracket and the proposed 4th bracket merging as early as 2015. The run shows that in 2011, 5.5% of tax returns would be subject to highest rate. By 2015, 7.3% of taxpayers would be subject to the highest rate and 12.7% of married filers would be subject to the highest rate. More and more taxpayers would become subject to the highest rate over time due to the lack of indexing.

One examples of this "bracket creep" is the federal AMT, alternative minimum tax. Here is an excerpt from the Congressional Budget Office document:

CBO *A series of issue summaries from the Congressional Budget Office*
No. 4, April 15, 2004

The Alternative Minimum Tax

For more than three decades, the individual income tax has consisted of two parallel tax systems: the regular tax and an alternative tax that was originally intended to impose taxes on high-income individuals who have no liability under the regular income tax. The stated purpose of the alternative minimum tax (AMT) is to keep taxpayers with high incomes from paying little or no income tax by taking advantage of various preferences in the tax code. The AMT does so by requiring people to recalculate their taxes under alternative rules that include certain forms of income exempt from regular tax and that do not allow specific exemptions, deductions, and other preferences. **For most of its existence, the AMT has affected few taxpayers, less than 1 percent in any year before 2000, but its impact is expected to grow rapidly in coming years and affect about one-fifth of all taxpayers in 2010. In her 2003 report to the Congress, the Internal Revenue Service's National Taxpayer Advocate, Nina Olson, labeled the AMT "the most serious problem faced by taxpayers."**[(1)]

Unlike the regular income tax, the AMT is not indexed for inflation. The accumulating effect of inflation is a key source of growing AMT coverage.

ANALYSIS OF GOV. DAYTON'S 4TH TIER WITHOUT INFLATION ADJUSTMENT

Proposed new 4th Tier Rate = 10.95%

2/23/2011

Filing Status	Proposed Start of 4th Bracket
Married Joint	$150,000
Married Separate	$75,000
Single	$85,000
Head of Household	$130,000

TAX YEAR	NUMBER OF TAX RETURNS	NUMBER OF RETURNS WITH TAX INCREASES	% OF RETURNS WITH TAX INCREASE	% OF MARRIED FILERS	% OF SINGLE FILERS
TY2011	2,536,380	138,278	5.5%	9.6%	2.3%
TY2012	2,585,775	155,490	6.0%	10.6%	2.6%
TY2013	2,635,452	167,303	6.3%	11.1%	2.8%
TY2014	2,686,985	181,704	6.8%	11.7%	3.1%
TY2015	2,736,837	201,123	7.3%	12.7%	3.4%

Estimated for tax years 2011-2015 using the House Income Tax Simulation (HITS) Model.

In tax year 2015, the inflation adjusted third bracket gets close to the noninflation adjusted proposed fourth bracket.

Filing Status	TY 2011 top of 3rd bracket	TY 2015 top of 3rd bracket
Married Joint	$134,170	$144,370
Married Separate	$67,090	$72,180
Single	$75,890	$81,660
Head of Household	$114,290	$122,980

Senate Fiscal Staff

News Release

For questions about individual income tax, please contact:
email: indinctax@state.mn.us
or call (651) 296-3781 or 1-800-652-9094
TTY: Call 711 for Minnesota Relay
Phone assistance hours are Monday - Thursday: 8:30 a.m. to 5 p.m. and Friday, 8:30 a.m. to 4:30 p.m.

For questions regarding other tax types, go to our tax information page and select a tax type.

For media questions ONLY - please contact:
Lisa Waldrup, Minnesota Department of Revenue
(651) 556-NEWS
email: lisa.waldrup@state.mn.us

For immediate release:

December 14, 2010

Minnesota Income Tax Rates

Saint Paul – The Minnesota Department of Revenue announced today that the state's individual income tax brackets for tax year 2011 will expand by 1.5 percent. State law requires the department to adjust the brackets to compensate for increases in inflation.

Expanding the brackets prevents taxpayers from being pushed into higher income tax brackets solely because of inflationary increases in their income. Since tax year 2000, Minnesota's income tax brackets have expanded by more than 30 percent as a result of inflation.

The bracket adjustments are based on the change in the U.S. Consumer Price Index for all urban consumers for the average of the 12 months ending August 2010. The index measures annual inflationary changes in the cost of basic goods and services. The department adjusts the brackets each year by the inflation factor and rounds the result to the nearest $10.

The brackets apply to tax year 2011. Taxpayers who make quarterly payments of estimated tax should use the following rate schedule to determine their payments, which are due starting in April 2011. Minnesota's tax rates remain the same.

2011 Minnesota Income Brackets and Rates for Taxable Income

	5.35%	**7.05%**	**7.85%**
Married, filing jointly	$0—$33,770	$33,771—$134,170	$134,171 & over
Married, filing separately	$0—$16,890	$16,891—$67,090	$67,091 &

over

Head of household	\$0—\$28,440	\$28,441—\$114,290	\$114,291 & over
Single	\$0—\$23,100	\$23,101—\$75,890	\$75,891 & over

Follow the latest news and updates from the Minnesota Department of Revenue on Twitter.

		Income Level where 10.95% Bracket will begin for single filers in real 2011 dollars			
	Number of Years from Now	Rate of nominal taxable income growth			
Tax Year		**3%**	**5%**	**7%**	**9%**
TY 2021	10	$ 63,248	$ 52,183	$ 43,210	$ 35,905
TY 2031	20	$ 47,062	$ 32,036	$ 21,966	$ 15,167
TY 2041	30	$ 35,019	$ 19,667	$ 11,166	$ 6,407
TY 2051	40	$ 26,057	$ 12,074	$ 5,676	$ 2,706
TY 2061	50	$ 19,389	$ 7,412	$ 2,886	$ 1,143

		Income Level where 10.95% Bracket will begin for joint filers in real 2011 dollars			
	Number of Years from Now	Rate of nominal taxable income growth			
Tax Year		**3%**	**5%**	**7%**	**9%**
TY 2021	10	$ 111,614	$ 92,087	$ 76,252	$ 63,362
TY 2031	20	$ 83,051	$ 56,533	$ 38,763	$ 26,765
TY 2041	30	$ 61,798	$ 34,707	$ 19,705	$ 11,306
TY 2051	40	$ 45,984	$ 21,307	$ 10,017	$ 4,776
TY 2061	50	$ 34,216	$ 13,081	$ 5,092	$ 2,017

Dr. John Spry

Nominal Threshold not adjusted for inflation

$ 85,000

Tax year		Rate of nominal taxable income growth 0.03	0.05	0.07	0.09
TY 2021	10 years	1.343916	1.628895	1.967151	2.367364
TY 2031	20 years	1.806111	2.653298	3.869684	5.604411
TY 2041	30 years	2.427262	4.321942	7.612255	13.26768
TY 2051	40 years	3.262038	7.039989	14.97446	31.40942
TY 2061	50 years	4.383906	11.4674	29.45703	74.35752

Income Level where 10.95% Bracket will begin for single filers in real 2011 dollars

Rate of nominal taxable income growth			
3%	5%	7%	9%
$ 63,248	$ 52,183	$ 43,210	$ 35,905
$ 47,062	$ 32,036	$ 21,966	$ 15,167
$ 35,019	$ 19,667	$ 11,166	$ 6,407
$ 26,057	$ 12,074	$ 5,676	$ 2,706
$ 19,389	$ 7,412	$ 2,886	$ 1,143

Nominal Threshold not adjusted for inflation

$ 150,000

Tax year		Rate of nominal taxable income growth 0.03	0.05	0.07	0.09
TY 2021	10 years	1.343916	1.628895	1.967151	2.367364
TY 2031	20 years	1.806111	2.653298	3.869684	5.604411
TY 2041	30 years	2.427262	4.321942	7.612255	13.26768
TY 2051	40 years	3.262038	7.039989	14.97446	31.40942
TY 2061	50 years	4.383906	11.4674	29.45703	74.35752

Income Level where 10.95% Bracket will begin for joint filers in real 2011 dollars

Rate of nominal taxable income growth			
3%	5%	7%	9%
$ 111,614	$ 92,087	$ 76,252	$ 63,362
$ 83,051	$ 56,533	$ 38,763	$ 26,765
$ 61,798	$ 34,707	$ 19,705	$ 11,306
$ 45,984	$ 21,307	$ 10,017	$ 4,776
$ 34,216	$ 13,081	$ 5,092	$ 2,017

Dr. John Spry

Q: How many states index important parts of their income tax structure for inflation?

A: There are three primary ways in which states currently index their tax structures: indexation of rate brackets, personal exemptions/credits, and standard deductions. The following chart shows the states that currently index each of these.

Why is Indexation Important?

Many features of personal income taxes are defined by fixed dollar amounts. For instance, income taxes have various rates starting at different dollar amounts of income. If these fixed amounts aren't adjusted periodically, taxes can go up substantially simply because of inflation. This phenomenon is known as "bracket creep." The same process tends to reduce the real value of other important features of the tax system, such as personal exemptions and standard deductions, over time as well.

In states that do not take account of the "bracket creep" problem, the existing tax structure is likely to be significantly less progressive than it was when the exemptions, deductions and rate brackets were first set at their current value. An extreme example of this effect can be seen in Alabama. The state's personal exemption has not been raised since the state income tax was adopted in 1933, and the standard deduction has not been raised since 1982. This has resulted in a significant decline in the real value of the exemption and deduction over time. For example, in 1982 the current $2,000 maximum standard deduction for single-filers was worth $3,449 in 1999 dollars.

The way the federal personal income tax code deals with this problem is by "indexing" these features of the tax code for inflation. This means that every year, the personal exemption, standard deduction and rate brackets are increased by the amount of inflation.

While several states have recently enacted legislation to index their tax structure, most have not. As the table at right shows, only 19 of the 42 states (including D.C.) with broad-based income taxes have passed legislation to index exemptions, deductions, or tax brackets for inflation--and only 7 states currently index all three of these factors.

States Indexing Their Tax Structure in 2000

State	Standard Deduction	Personal Exemption/Credit	Rate Brackets
Arkansas	N	N	Y
California	Y	Y	Y
Colorado	Y	Y	N*
Idaho	Y	Y	N
Iowa	Y	N	Y
Maine	Y	Y	Y
Michigan	N**	Y	N*
Minnesota	Y	Y	Y
Missouri	Y	N	N
Montana	Y	Y	Y
Nebraska	Y	Y	N
New Mexico	Y	Y	N
North Dakota	Y	Y	N
Ohio	N**	Y	N
Oregon	N	Y	Y
Rhode Island	Y	Y	Y
South Carolina	Y	Y	Y
Utah	Y	Y	N
Vermont	Y	Y	Y
Wisconsin	Y	N	Y
States Indexing	16	16	11
Addendum:			
States (including DC) with Broad-Based Income Taxes: 42			

* Levies a flat-rate income tax; indexing not possible
**Does not allow a standard deduction

Last Updated 3/27/2000

Back to Main FAQ Page

Citizens for Tax Justice

ALABAMA

Filing System: Joint

TAX BASE: STATE ADJUSTED GROSS INCOME

Major Differences from Federal Law

Interest/Dividend	Exempts U.S. government bonds.
Business/Rent/Farm	State schedule for rental income.
Capital Gains & Losses	Same as federal, except all gains are taxable and all losses deductible in year incurred.
Pension/Retirement Income	
--Private	Payments from defined benefit plans are exempt.
--Public	Most systems exempt.
--U.S. Civil Service	Exempt.
--Military	Exempt.
Active Duty Military	Same as federal.
Unemployment Compensation	Exempt.
Social Security Benefits	Exempt.
State/Municipal Bond Interest	Taxable except Alabama obligations.
Health Savings Accounts	No provision.
Miscellaneous	
Disability Income	Same as federal.
Lottery Winnings	Taxable.
Federal Income Taxes	Deductible.
Other	Moving expenses 100% deductible if new job is in Alabama. Certain adoption expenses are deductible. All benefits from Alabama prepaid tuition contracts are exempt, as are up to $5,000 in payments to such contracts. Up to $25,000 in severance pay is exempt if a result of administrative downsizing. Health insurance premiums 50% deductible if paid by certain small business employees.

DEDUCTIONS

Standard:
Sliding scale standard deduction, ranging from a maximum to a minimum amount over income up to $30,000 per filer.

	Standard Deduction	
Filing Status	Minimum	Maximum
Single	$2,000	$2,500
H-H	2,000	4,700
Married-J	4,000	7,500
Married-S	2,000	3,750

Itemized:
State itemized deductions.

Major Differences from Federal Law:
Medical: Limited to amount by which medical costs exceed 4% of AGI, except all long-term care premiums are fully deductible.
Taxes: State income taxes and state and local sales taxes not deductible; deduction for FICA, federal self-employment tax, railroad retirement.
Casualty and Theft: Loss must be reduced by 10% of AGI and claimed in year occurred.

TAX RATES AND BRACKETS

Taxable Income Brackets		Marginal
Single/Married-S/HH	Married-Joint	Tax Rates
$0 - $500	$0 - $1,000	2.0%
501 - 3,000	1,001 - 6,000	4.0
3,001 and over	6,001 and over	5.0

EXEMPTIONS

Single/Married-S $1,500
Married-J/HH 3,000

AL AGI	Dependent Exemption
$0 - $20,000	$1,000
20,001 - 100,000	500
Over 100,000	300

TAX CREDITS

- Capital credit
- Coal credit
- Employer-sponsored basic skills education credit
- Enterprise zone
- Income taxes paid to other states
- Rural physician's tax credit

CONTRIBUTION/CHECK-OFF

- Alternative fuels fund
- Arts development fund
- Breast and cervical cancer research program
- Cancer research institute
- Child abuse trust fund
- Election campaign fund
- Foster care trust fund
- Indian children's scholarship fund
- Low-income weatherization
- Mental health
- Military support foundation
- National Guard foundation

CONTRIBUTION/CHECK-OFF (cont.)

- Nongame wildlife fund
- Organ donor awareness
- Public health and disease prevention
- Senior services trust fund
- Veterans' program
- 4-H Club

OTHER TAXES

- Penalty on early withdrawal of savings
- Use tax

 WI Legislative Fiscal Bureau, Jan. 2011