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Session Wrap

A look at the tax and fiscal aftermath of the 2021 Special Session and why a "miscellaneous" provision deep in the tax bill may eventually turn out to be the most influential long-term tax policy action arising out of this strange year.

As this year's special session dragged on and lawmakers crept toward the precipice of a government shutdown, leadership assured everyone that budget agreements would be reached in time. Lawmakers delivered on that assurance, but in the process proved money doesn't necessarily buy timely conclusions to legislative sessions.

For the fourth consecutive biennial budget session, lawmakers ran through the constitutional stop sign. The legislature might not consider the May deadline a functional anachronism, but it's certainly been treated as one. All the special extenuating circumstances surrounding COVID and public safety reform certainly didn't help, but this is now a regular feature of state lawmaking, at least during times of divided government. When the Minnesota Supreme Court ruled in 2017 that a shutdown means the state would actually shut down, June 30 became the "real" budget deadline date – the one that actually has teeth.

Moreover, some legislators have suggested the deadline has become a practical anachronism as well due to state government's modern size and complexity. They observe the scope of the general fund budget is much larger and infinitely more complex than when the state constitution was ratified. Indeed, for most of the state's history, local rather than state government budgets were predominant and preeminent. It's even arguably different now than it was as recently as 1971 when the legislature created a commission to study the constitution and make recommendations to maintain its utility. In that year, property tax collections were still over 35% larger than state individual income and state sales tax collections ***combined*** – an indication of local government's continuing relative primacy. Today, these two state revenue workhorses support twice as much government per year as property taxation, but lawmakers still have the same roughly 75 days to pull together a general fund budget.

Be that as it may, the work is done – at least for the time being. Here's a look at the tax and fiscal aftermath of the 2021 Special Session and why in future years it may turn out – looking back in retrospect – that the most influential long-term tax policy action arising out of this strange year came from a provision filed under "miscellaneous."

The Big Picture on Spending

Table 1 presents how the new general fund budget shakes out. The $52.3 billion for FY 22-23 is a $1.73 billion (3.4%) increase over February forecasted spending under current law for FY 22-23 and a $3.9 billion (8.1%) increase over what was enacted 2 years ago. Since changes in the general fund budget relative to the February forecast present a state budget picture using a baseline of current law spending, it has the potential to mask the budget impacts current law actually has on the budget growth over time. As

Table 1: FY2022-23 General Fund Budget, February Forecast and As Enacted

Budget Area	FY 2020-21 As Enacted	FY 2022-23 Feb Forecast	FY 2022-23 As Enacted	Enacted vsFeb Forecast	
				Amount	Percent
E-12 Education	20,113,272	20,429,204	20,986,660	557,456	2.7%
Higher Education	**3,405,828**	**3,406,128**	**3,511,468**	**105,340**	**3.1%**
Property Tax Aids and Credits	3,840,757	4,164,181	4,238,573	74,392	1.8%
Health and Human Services	14,739,455	16,249,747	16,682,977	433,230	2.7%
Public Safety & Judiciary	2,490,366	2,538,147	2,638,995	100,848	4.0%
Transportation	**331,475**	**249,552**	**457,232**	**207,680**	**83.2%**
Environment	339,013	331,988	368,878	36,890	11.1%
Agriculture & Housing	287,853	243,542	264,858	21,316	8.8%
Jobs, Econ Dev, & Commerce	299,531	314,636	511,641	197,005	62.6%
State Government & Veterans	1,150,285	1,169,849	1,248,386	78,537	6.7%
Debt Service	1,182,796	1,263,777	1,242,865	-20,912	-1.7%
Capital Projects	**272,970**	**316,473**	**316,473**	—	—
Cancellations/Other Spending	17,319	-20,000	-78,523	-58,523	NA
Total Spending	**48,470,920**	**50,657,224**	**52,390,483**	**1,733,259**	**3.4%**

Sources: General Fund Tracking, End of Session 2019 and 2021, Minnesota House Fiscal Analysis Department; calculations by MCFE.

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always, nowhere is this more relevant than in the Health and Human Services area. As the table shows, while the actions of lawmakers this year boosted general fund HHS spending by an additional $433 million,[1] actual biennium-on-biennium growth is in the range of just under $2 billion.

Federal Government Funds: Eligible Uses Could Change

The biggest fiscal question hanging over this year's budget deliberations was if, how, and to what extent $2.83 billion in federal fiscal recovery cash could be used to support general fund spending or offset existing general fund expenses. That question took on much greater relevancy in mid-May when long-anticipated Treasury guidance indicated the state had a lot more flexibility in using the money for general government services than had been anticipated. At the same time caution was warranted not just because of the unpredictability of COVID recovery and its ongoing spending demands, but because of the potential for triggering federal recoupment of funds through various tax actions. The parties may have profoundly different perspectives on matters of state taxing and spending, but they are certainly unified on one core fiscal idea: don't give money back to the federal government.

Money is fungible, so it's fair to say nearly every cent of revenue replacement from Fiscal Recovery Funds appropriated for the current FY22-23 biennium (so far) is going to PPP loan forgiveness and unemployment tax relief.

In the end, the enacted State Government Finance bill appropriates federal fiscal recovery funds in four ways:

- $500 million goes to a new "COVID Flexible Response Account." This is the carved-out sum appropriated to MMB to pay for the Governor's chosen COVID response priorities such as summer education programs. Like last year's COVID 19 Minnesota Fund, certain proposed expenditures are subject to the COVID Response Commission's review and recommendation process,[2] although the threshold for triggering a review is increased from $1 million to $2.5 million.

- $663.1 million goes to general fund revenue replacement in FY 22-23

- $550 million goes to general fund revenue replacement in FY 24-25

- $1.15 billion is reserved for the 2022 legislative session or a special session before then. This sum may only be spent as appropriated by the legislature in law (The agreed upon $250 million for pandemic bonus pay later this year would come out of this pool).

As these figures indicate, lawmakers chose to leave a considerable amount of federal support on the bottom line – roughly $1.65 billion to be exact – for future decision-making. In addition, the $663.1 million which was appropriated for the current biennium essentially equals the $669 million biennial price tag of federal conformity (almost all of that being PPP loan forgiveness) and the unemployment subtraction — both approved uses of recovery funds. Money is fungible, so it's fair to say nearly every cent of revenue replacement from Fiscal Recovery Funds appropriated for the current FY22-23 biennium (so far) is going to PPP loan forgiveness and unemployment tax relief.

Leaving money on the table for future appropriations enhances budgetary flexibility and financial stability (and may have made closure this year a little easier with fewer resources to fight over). It also improves the odds of getting out of the 2022 session on time while generating a lot of goodwill with voters in an election year. However, the strategy is not without some risk with respect to the most flexible use of federal dollars: providing general government services.

Treasury guidance on the use of recovery funds for general government purposes dictates that if the state's revenue collections have "recovered" as determined by a formula provided by Treasury, then the money can no longer be used for this purpose. The next recovery checkpoint is December 31, 2021. Given the state's recent revenue collection trends, it seems entirely possible (and we think highly probable) that the door will close on general government uses of ARPA funds as early as the end of this year.

Minnesota would then still be able to spend recovery funds on three other uses: pandemic response (which is a rather accommodating category in its own right), more premium pay, and water/sewer/broadband infrastructure. The state finance bill addressed this contingency by stating if the transfer of ARPA funds to the general fund for the provision of government services is not allowed, then MMB is authorized to replace a comparable amount of enacted general fund appropriations in that biennium (appropriations that represent permissible uses of ARPA funds.) But as COVID's health and economic impacts presumably diminish going forward, we would expect reimbursable COVID expenses will be getting harder to come by and justify. That's especially true when $5 billion in additional ARPA funds are being distributed throughout state and local government to address COVID's health and economic fallout. How can $550 million of forecasted general spending two years from now be linked to COVID recovery actions and be eligible for federal fund use/reimbursement under Treasury's guidance? We don't doubt lawmakers and MMB would work hard to find a way to make that happen.

The Tax Bill – Fighting for COVID's Table Scraps

Early in the session initial concerns surrounding the tax bill centered on the possibility that various forms of tax cuts/relief could have the unintended effect of triggering recoupment of federal dollars. That concern faded as MMB reported collections well over forecast, culminating in the May

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1 Includes a $100 million transfer from the budget reserve.

2 The make-up the commission would require a majority of the House and the Senate commission members to prohibit an expenditure, which under the current commission composition, makes any such prohibitions unlikely.

update declaring fiscal year-to-date receipts were already $2.17 billion above what was projected in the February forecast. It appears Minnesota will have plenty of "organic growth" – in the words of Treasury – to offset any clawback concerns. Moreover, most of the revenue reductions in the tax bill arise out of conformity to federal PPP loan forgiveness and unemployment insurance exclusion, neither of which count as revenue reductions in eyes of Treasury. Of the $745.6 million in biennial revenue reductions from tax policy changes, 86% come from just these two provisions.

These two provisions were commonly described as "tax cuts" in the media, although "tax relief" is a better label given the temporary, mostly one-time nature of these reductions. An even more accurate description would be "tax abeyance," since in non-emergency conditions both types of income would – and if adhering to good tax principles should — be taxed. According to the Department of Revenue, the approximately 487,000 returns claiming the unemployment subtraction will have an average reduction in tax of $482 in tax year 2020. For the PPP loans, Revenue estimates 24,800 returns will have an average benefit of $9,300 for loans in tax year 2020, and 28,000 returns will have an average benefit of $5,100 for tax year 2021.

The price tag of the PPP and unemployment provisions had major ramifications for the rest of the tax bill by consuming so much of the global target for taxes. With regards to the state's rather lengthy federal conformity decision-making agenda, lawmakers decoupled from several provisions and adjusted effective tax years for most of the rest (by typically limiting conformity to tax year 2020 and earlier). A lot of this partial or temporary conformity can probably be expected to be revisited next year in the 2022 session. Similarly, the mish-mash of small individual and corporate income tax credits and exclusions that survived in the omnibus bill were often reduced by limiting effective tax years, capping allocations, or making other tweaks. A couple of provisions with slightly more noticeable budget impacts in this biennium or the next are:

- $20 million of local homeless prevention aid to counties per year (beginning in FY 24);
- A $50,000 increase in the market value exclusion for the state general levy (with a $10.6 million per year reduction in the levy in FY23 to avoid shifting, increasing to $20 million per year in the out-biennium);
- A new housing tax credit for contributions made to an affordable housing account (about $10 million per biennium, effective tax year 2023); and
- $30 million to counties to pay for property tax refunds owed by local governments to utility and pipeline companies due to state overassessment. Although this is one-time aid, there are more potential refunds in the pipeline (no pun intended). They are smaller but generally impact more counties. For that reason, the tax bill also included a provision requiring the commissioner of revenue to perform a review of the process by which utility and pipeline properties are valued.

A few other non-fiscal impact provisions are worth flagging. At the top of the list is the pass-through entity tax. Minnesota has now joined 15 other states in providing higher income resident relief from the 2017 Tax Cuts and Jobs Act's $10,000 cap on the state and local tax (SALT) deduction without lowering state tax revenue. The state budget reserve amount has been updated to $2.38 billion, and a new "revenue shift fix" has been tacked on to the pre-session allocation of any surplus revenues arising out of the November forecast. This one reduces the percentage of accelerated June sales tax liabilities until the percentage is reduced to zero. It is sixth in the pecking order behind items like budget reserve replenishment and paying back school shifts. With regards to property taxation, summary budget information on local units of government and percent changes in their proposed levies for the following year will accompanying taxpayer notices of proposed property taxes beginning in tax year 2023.

Wrestling with Tax Expenditures

Overlooked in the narrative of tax relief and buried deep in the text of the omnibus tax bill's "miscellaneous" article is a provision offering possibly the biggest lasting and beneficial impact on the state's tax system. The provision launches a serious effort to bring tax expenditures into the biennial budget process thanks to the leadership of House Tax Chair Marquart, who has been a champion for this cause for some time, and the support of Senate Tax Chair Nelson.

The centerpiece of the legislation is the establishment of a new tax expenditure review commission. It will be comprised of four senators (two appointed each by Senate majority and minority leaders) four House members (two appointed each by House Speaker and minority leader) and the commissioner of Revenue (or designee). Supported administratively by the Legislative Budget Office and the Department of Revenue, the commission for the first three years will conduct an initial review and identify evaluation measures. After this period, tax expenditures will be reviewed on a regular rotating basis, which among other things would include:

- measurable impacts and efficiency of the expenditure;
- comparison of effectiveness to a direct expenditure;
- potential modifications to improve efficiency and effectiveness;
- potential revenue-neutral rate reduction from repeal;
- cumulative fiscal impacts of other state and federal taxes providing benefits for similar activities; and
- a recommendation of whether the expenditure should be continued, repealed, or modified.

The commission will be required to submit a report to the legislature by December 15 of each year, and tax committees are required to hold a public hearing with testimony in the year following the submission of the report.

Minnesota's biennial tax expenditure budget report, long regarded as a model for other states, will also be enhanced. Beginning in 2024, the report will include incidence analysis of significant sales and income tax expenditures,[3] estimates of revenue neutral rate reductions from repeal, and purpose statements for each expenditure communicating the rationale for its policy existence. The enhanced report will be published in

[3] "Significant" is defined as all tax expenditures excluding those incorporated into state law by reference to a federal definition of income, results in a revenue reduction of less than $10,000,000 per biennium, or is a business tax credit (because Revenue's incidence database isn't sufficiently granular for corporate or pass-through business taxes).

November of every even numbered year to align it with the biennial budget session.

Having a good definition of what constitutes a tax expenditure is important, and definitional debates have often been a thorn in the side of making progress on this topic. The bill also amends the definition of tax expenditure to exclude provisions that mitigate tax pyramiding on intermediate business-to-business inputs. (It should also exclude comparable corporate tax provisions like the dividend received deduction).

Finally, the legislation requires any bill that creates a new tax expenditure or continues an expiring tax expenditure must include an expiration date for the tax expenditure that is no more than eight years from the day the provision takes effect.

As we have stated before, tax expenditures are not by definition bad policy. They can support important public policy goals. But they can also:

- cause tax rates to be higher than they need to be;
- introduce significant amounts of administrative complexity and cost into the tax system;
- create perverse incentives; and
- violate important tax principles like treating equals equally.

Contrary to popular belief, tax expenditures do not shrink the size of government. Taxpayers who do not benefit pay higher rates for the same size of government. If forgone revenue would have been used for a rate cut, the size of government has gone up not down.

The smart money is probably on lowering expectations from this initiative. As *State Tax Notes* columnist Billy Hamilton recently observed about these provisions, "The political inertia of doing nothing is amazingly powerful, regardless of which party controls the legislature and governor's office."[4] But even if political inertia wins, it won't be because we don't have a much better and needed understanding of what we are doing with our tax system, why we are doing it, and what the implications are for both the state and taxpayers themselves. ■

[4] "The Stubborn Stickiness of Tax Expenditures," *State Tax Notes*, December 10, 2020.

Income Taxes, the TCJA, and Taxpayer Migration

We take a closer look at the influence of the SALT cap on effective tax rates, what the new IRS Statistics of Income releases are communicating about Minnesota taxpayer migration, and offer some thoughts on the implications for Minnesota's income tax debates.

"SALT Cap Confounds Doomsayers as Fears of Exodus Prove Overblown"

—Bloomberg News, June 1, 2021

As this recent headline indicates, there is new fodder in the never-ending debate over the role state income taxes play on taxpayer relocation. Newly-released Statistics of Income data from the Internal Revenue Service indicates the Tax Cuts and Jobs Act (TCJA) caps on state and local tax deductibility so far has had a negligible initial impact on the nation's domestic migration patterns.

The data also reveals a much more complex story surrounding migration of higher income households than the common debate over wealthy retired taxpayers and their greater mobility.

Such a finding shouldn't be surprising. Nobody should really have been expecting an Oklahoma land rush-type exodus out of states due to the cap on state and local tax deductibility. For starters, the amount of interstate migration that occurs in any year – for ***any*** reason let alone taxes – is small, about 2% according to the latest Census Bureau estimates on a population basis, less on a tax filer basis. Moreover, research on taxes and migration have generally found taxes matter on the margin, but they're just one of many factors. That appears to be true even for taxpayers who are most affected by high state income taxes and are the most economically mobile. One study of administrative tax returns over 13 years (45 million tax records), tracked the states from which millionaires file their taxes. It concluded "millionaire tax flight is occurring, but only at the margins of statistical and socioeconomic significance."[5]

But the underlying economics of state and local taxes (SALT) did change with the passage of the TCJA. The $10,000 limit on state and local tax deductibility made SALT more economically relevant because of the potentially large impact on federal tax burdens. That is especially true for Minnesota's higher income filers who disproportionately benefitted from SALT deductibility. As a result, the math underlying taxes and residency decision-making has changed for many to some degree. We take a closer look at the influence of the SALT cap on effective tax rates, what the new IRS Statistics of Income releases are communicating about Minnesota taxpayer migration, and conclude with some thoughts on the implications for Minnesota's income tax debates.

Low Sodium ETRs

Taxpayer returns change from year to year in part due to ordinary fluctuations and changes in the makeup of taxpayer income. This can present a challenge in quantifying the before and after impact of any policy change, even when comparing an "average" tax filer in different states. For example, in our latest national individual income tax comparison study the income make-up of our post-TCJA $1 million married joint filer featured 3.1% more taxable income (or conversely 37% less non-taxable income) than our pre-TCJA $1 million filer. That alone results in a federal tax increase independent of any policy influence not just for Minnesota but all states when imputing that profile change onto the rest of the country. Layering com-

[5] "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data," Young, Varner, and Laurie, *American Sociological Review*, May 26, 2016.

Table 1: Aggregate Federal Effective Tax Rates (ETR) of Millionaire Income Filers ($ in thousands)

	National			States Without Income Tax			Top Ten Most Progressive Income Tax States		
	2017	2018	Change	2017	2018	Change	2017	2018	Change
AGI	1,662,108,213	1,782,809,578	7.3%	421,054,514	429,430,512	2.0%	680,288,726	684,075,402	0.6%
Tax Paid	463,168,812	477,029,988	3.0%	120,784,243	113,187,094	-6.7%	186,789,882	196,607,208	5.0%
ETR	27.9%	26.8%	-4.0%	28.7%	26.4%	-8.1%	27.5%	28.7%	4.7%

Source: IRS Statistics of Income Historic Table 2

plex policy changes like the TCJA that affect both adjusted gross income and taxable income in multiple ways makes the isolation of the effects of particular provisions even more problematic.

Perhaps the best perspective of how the SALT cap can affect filers in different states differently can be gained from looking at "before and after" aggregate effective tax rates (ETR) of millionaire income filers - whose tax burdens are most likely impacted by the SALT cap — and comparing the results in states with and without a state income tax (Table 1).

As the national column shows, federal adjusted gross income grew 7.3% but the net effect of TCJA changes and rate reductions resulted in a more modest 3.0% increase in federal taxes paid yielding a reduction in the effective tax rate of millionaire filers of 4%. States without an income tax had lower AGI growth than the national average but experienced a 6.7% reduction in federal taxes paid on income resulting in effective tax rate decline of 8.1%.

In stark contrast, even though year-on-year AGI growth in the top 10 most progressive income tax states[6] was more anemic, federal taxes paid increased by 5% resulting in an effective tax rate increase of 4.7%. Of these 10 states, three — New York, California, and Connecticut — constitute 82% of the total AGI for this group meaning their experience is largely driving these results. All three of these states experienced 2017-2018 effective tax rate increases indicating the loss of SALT deductibility more than offset TCJA rate reductions in the aggregate. It is not at all surprising that the push for restoring SALT deductibility resides in their congressional delegations.

Table 2 presents Minnesota's results. Growth in federal adjusted gross income among these filers was above the national average. SALT deductions fell by a whopping 97.4% exposing more income to federal taxation. Yet, rate reductions and other TCJA tax cut benefits offset the loss of SALT deductibility resulting in a slight decrease in the federal effective tax rate paid in the aggregate by Minnesota millionaire filers. The implications relevant to location decision-making is how Minnesota high income filers might evaluate and weigh any smaller absolute benefits obtained through the TCJA in Minnesota compared to potentially larger tax benefits now available elsewhere.

A Closer Look at Minnesota Migration Findings

New IRS Statistics of Income information on state migration[7] is based on year-to-year address changes reported on individual income tax returns filed with the IRS. It captures both inflows (the number of new residents who moved to a state and where they migrated from) and outflows (the number of residents leaving a state and where they went.) as well as the adjusted gross income each flow represents. Tax returns are matched for two consecutive calendar years based on the filer's taxpayer identification number.

Migration statistics from the IRS have long been a bit of a Venus fly trap for reporters and policy commentators — attracting them with seemingly straightforward, intriguing data linking migration with income flows only to find themselves caught reporting on erroneous data uses and interpretations. The most common mistake is that the reported adjusted gross income (AGI) associated with migration does not necessarily move. A lot of reported AGI change is actually "location bound" — the migrant may leave but whether or not the AGI leaves depends on the nature and source of the income. Most labor income stays with an employment position. AGI on a "moved" return may represent income that was in the other state already but is now received by a new taxpayer. Intangible income (e.g. interest and dividends) do leave, but business income is highly ambiguous. As a result, contrary to how it is often represented, outmigration of AGI is not the same as "lost money." In addition, simply comparing net AGI inflows to outflows in a particular year fails to take into account AGI was earned prior to departure. Together this has often led to migration-related reporting that is both faulty and overstated.

However, IRS migration data can still provide useful insights and perspective on interstate taxpayer migration. That is truer now with recent IRS data reporting improvements allowing users to see pre- as well as post-migration income (addressing the latter problem above) as well as enabling an examination of the average impact of migration for each state broken down by age and income. Looking at the most recent release (and some previous releases for trend purposes)

[6] Based on $500,000 dollar MFJ filers in MCFE's 2021 Individual Income Tax Comparison Study (CA, CT, HI, ME, MD, MN, OR, NJ, NY, and VT).

[7] https://www.irs.gov/statistics/soi-tax-stats-migration-data-2018-2019

Table 2: Pre- and Post-TCJA Aggregate Federal Tax Changes for Minnesota $1 Million and Above Filers (in thousands)

	2017	2018	Change
AGI	21,896,103	23,830,877	8.8%
Itemized Deductions	3,186,472	1,440,369	-54.8%
SALT	2,374,654	61,374	-97.4%
Federal Tax Paid	6,020,606	6,410,073	6.5%
ETR	27.5%	26.9%	-2.2%

Source: IRS Statistics of Income, Historic Table 2 here are three findings we found interesting relevant to high income filers specifically and Minnesota migration generally.

1. Taxpayer net out-migration in the most recent reported year exceeded taxpayer in-migration by almost 2 to 1, but Minnesota continues to hold its own in gaining taxpayers from many states from around the country.

As Table 3 shows the number of states that were net "providers" and net "receivers" of Minnesota taxpayers is nearly equal. More specifically:

- Minnesota is contributing to the national migration trend to the south and west. Just five states – Florida, Arizona, Texas, Colorado, and Washington – comprised over 70% of all Minnesota tax filer out-migration. However, the most recent data show Minnesota as a net "winner" from a perhaps surprising diversity of states around the country.

- These findings often continue a trend that has existed for many years. Since 2012-13 Minnesota's net migration status has not changed with 27 states. That includes continuing net in-migration from several populous states in the Upper Midwest. IRS reports Minnesota has experienced positive net migration with Iowa, Illinois, Indiana and Michigan every year and been a net recipient from Wisconsin — by far our largest "trading partner" — in every year but one.

Table 3: Minnesota Net Migration Based on the population of Forms 1040 that were filed and processed by the IRS during calendar years 2018 and 2019*

Net Increase in MN Filers from In-Migration			Net Decrease in MN Filers from Out-Migration		
Alaska	Louisiana	North Dakota	Alabama	Massachusetts	Tennessee
Connecticut	Maine	Oklahoma	Arkansas	Maryland	Texas
Delaware	Michigan	Pennsylvania	Arizona	Montana	Utah
Hawaii	Mississippi	Rhode Island	California	Nevada	Washington
Illinois	Missouri	Vermont	Colorado	New Mexico	Wyoming
Indiana	Nebraska	Virginia	DC	North Carolina	
Iowa	New Hampshire	West Virginia	Florida	Oregon	
Kansas	New Jersey	Wisconsin	Georgia	South Carolina	
Kentucky	New York		Idaho	South Dakota	
Net MN Filer Increase: 3,242			**Net MN Filer Decrease: 6,267**		

*Returns received in 2018 represent income that was earned in 2017 (pre-TCJA).
*Returns received in 2019 represent income that was earned in 2018
Source: IRS Statistics of Income Gross Migration File, 2018-2019

Table 4: MN Migration of Filers with Over $200,000 Income, By Age, 2018-2019 (income earned in 2017 and 2018)

OUT-MIGRANTS	Returns	2017 ($000)	2018 ($000)	Avg Change per Return	AGI/Return ($)
<26	26	6,854	17,624	414,231	677,846
26-35	312	87,332	111,131	76,279	356,189
35-45	685	197,422	260,548	92,155	380,362
45-55	714	325,081	368,347	60,597	515,892
55-65	759	435,671	547,248	147,005	721,012
Over 65	557	256,901	276,819	35,759	496,982
TOTAL	**3,053**	**1,309,261**	**1,581,717**	**89,242**	**518,086**

IN-MIGRANTS	Returns	2017 ($000)	2018 ($000)	Avg Change per Return	AGI/Return ($)
<26	13	6,694	7,048	27,231	542,154
26-35	383	115,886	151,534	93,076	395,650
35-45	578	175,219	220,472	78,292	381,439
45-55	491	195,234	218,012	46,391	444,016
55-65	402	163,413	178,334	37,117	443,617
Over 65	396	144,145	161,994	45,073	409,076
TOTAL	**2,263**	**800,591**	**937,394**	**60,452**	**414,226**

Source: IRS Statistics of Income Gross Migration File, 2018-2019

2. Migration of higher-income taxpayers is a lot more complicated than rich retirees moving to low tax states.

As Table 4 shows, among filers with incomes in excess of $200,000 [8] there was 35% (790 filers) more Minnesota out-migration than in-migration in the most recent reported year. But the data also reveals a much more complex story surrounding migration of higher income households than the common debate over wealthy retired taxpayers and their greater mobility:

- Of all the age groups, the over 65 cohort had the smallest average income change from those moving out of Minnesota. Moreover, although 161 more fliers left the state than entered in this cohort, those who migrated into Minnesota featured an average income increase nearly $10,000 higher than those who left.

- 60% of all of Minnesota's highest-income migration occurred in the "prime working years" — ages 26-54. Within this age and income combination, 18% more filers out-migrated than came to Minnesota. However, some good news can be found within the youngest high income, prime working cohort (26-35), Minnesota experienced net positive migration featuring an average income change for arrivals 22% higher than those who left the state.

- Passage of the TCJA does not seem to have had any significant immediate impact on high income taxpayer migration. Outmigration of $200,000 and above filers is largely consistent before and after enactment of the TCJA (3,053 in the year after enactment versus a 3,018 average in three years prior to enactment.)

3. Looking more broadly at taxpayer migration in working years, Minnesota's appearance of "migration equilibrium" masks a net outmigration trend of moderate to higher income filers.

[8] Above $200,000 is the highest income classification reported in IRS Gross Migration Statistics.

As economic geographers note, the primary economic impact of migration is in shrinking or growing the productive and consumptive base of the economy through the movement of labor. For this reason, it's worth taking a look at migration trends within the full workforce age demographic.

At first glance it appears Minnesota general workforce migration trends are remarkably stable. Over the last four years 2,039 more working age (under 65) tax fliers migrated to Minnesota than left — a difference of only 1%. Out-migration and in-migration of Minnesota's prime workforce ages 26-54 is largely balanced. Both the number of returns and the average change in income per return are almost identical. Since 2015-16, prime workforce in-migration has exceeded out-migration by 5.9% (7,285 filers) and the average change in AGI among those who came to the state is a rather miniscule $60 less than those who left it.

However, when cross referencing workforce age returns by AGI income levels (Table 5), a different trend emerges:

- For each year, net migration for working age filers with $75,000 or more income was negative, even in the two years when the net migration of all working age filers was decidedly positive.
- For the last four reporting years, the out-migration of working age filers over $75,000 comprised between 82.9% and 87.4% of all state outmigration with incomes over $75,000.

Are We Discussing the "Right" Migration Concerns?

Even with the IRS's data improvements, tax migration information is far from perfect. For example, the IRS uses return addresses in assembling this data, not the actual residence of the taxpayer. Therefore, migration findings could be affected by any filer whose return address isn't their residential address (out of state tax preparer, using a P.O. Box, business address if they have pass-through income, etc.). Foreign filer migration is not included in these figures. Various timing issues regarding income, taxpayer movement and filing are another potential complication. And, of course, any single year can be an outlier. Care needs to be given in reading too much into the findings.

However, there are some results and recent trends that merit observation and continued monitoring:

- By far most taxpayer migration – in and out — occurs among younger taxpayers in the workforce, not retirees.
- More high-income migration occurs within the workforce, rather than among those in, or near, retirement.
- Overall net migration trends in the workforce "mask" net outmigration trends among some important workforce demographic cohorts.

Given this, it's fair to call into question lawmakers' continuing focus on the movement of seniors with respect to state income tax policy. Some of that is due to the fact that older and wealthier taxpayers contribute to the economy through their own consumption, philanthropy, volunteerism, and local investment as well as their tax dollars. (We suspect the fact that they vote in disproportionately larger numbers might have a little something to do with this emphasis too.)

But the foundation for long-run economic growth resides in the earning potential and productivity of the workforce, and net workforce out-migration can be an indicator that something is out of whack. As one scholar has stated it, "net out-migration can be a signal that a state's economy is not providing sufficient opportunities for some residents to use their skills fully and to improve their standard of living. Out-migration can damage a state's long-term growth prospects if the people leaving tend to be working-age adults with critical job skills, high levels of education, and strong entrepreneurial drive." [9]

At the same time, workforce in-migration trends demand equal attention since they reflect the intersection of capital mobility, workforce location, and business decision making. Cost of labor and the need for geographic pay adjustments have long been recognized as one of many influences in business siting decisions. The individual income tax can be part of this calculus. As one research study has described it, the effect of the personal income tax on economic growth is a potential "double edged sword."[10] All else equal, higher individual income taxes create an incentive for individuals to apply their talents elsewhere. But if employers must compensate employees for the higher burden with higher pre-tax wages to level the playing field, their labor costs go up and the case for expanding and growing business within Minnesota becomes that much more challenging. According to a recent study of cost-of-living adjusted salaries, the Minneapolis/St. Paul/Bloomington metropolitan statistical area trails 17 of its 20 peer metropolitan areas.[11] This finding does not include individual income tax considerations.

It's in this context that IRS migration data deserve consideration. To be sure, in the grand scheme of the Minnesota workforce, the amounts of net-outmigration reflected in this data may appear to be nothing more than decimal dust. Yet any steady "drip, drip, drip" of continuing net outflow among moderate-to-high-income filers in the workforce is worth reflecting on — especially as interest in increasing our reliance on the individual income tax even more is not going away. ■

Table 5: Minnesota Net Workforce Migration (Age under 65)
No. of Returns By Year and Selected Income Ranges, 2015-2019

	2015-2016	2016-2017	2017-2018	2018-2019
Net Migration: Under 65	-881	3,583	1,292	-1,955
Under 65 with AGI of $75,000 - $100,000	-537	76	-307	-595
Under 65 with AGI of $100,000 - $200,000	-886	-467	-547	-1,055
Under 65 with AGI of Over $200,000	-796	-347	-344	-629
Net Migration: Under 65, $75,000 Income and Above	**-2,219**	**-738**	-1,198	-2,279

*Returns received in 2018 represent income that was earned in 2017 (pre-TCJA).
*Returns received in 2019 represent income that was earned in 2018
Source: IRS Statistics of Income Gross Migration File, 2018-2019

9 "State "Income Migration" Claims Are Deeply Flawed" Mazerov, Center for Budget and Policy Priorities, October 20,2014

10 Mark Rider, The Effect of Personal Income Tax Rates on Individual and Business Decisions – A Review of the Evidence, Working Paper 06-15, Andrew Young School of Policy Studies, Georgia State University.

11 https://www.hiringlab.org/2019/08/27/adjusted-salaries-2019/

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