FISCAL NOTE

Bill #: HB636 **Title:** Statewide sales tax replacing income tax

Primary Sponsor: Dan Fuchs **Status:** 2nd Reading, Amended

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Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY2002 Difference	FY2003 Difference
Expenditures:		
General Fund	$7,715,139	$7,844,971
Revenue:		
General Fund	$0	$16,664,600
State Special Revenue	$0	$(12,000)
Net Impact on General Fund Balance:	**$(7,715,139)**	**$8,819,629**

Yes	No		Yes	No	
	X	Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached		X	Family Impact Form Attached

The fiscal impacts of HB636 will depend on contingency language contained in the bill. The contingency language references HB635, which provides for a referendum to change the Montana Constitution to allow a maximum sales tax rate of 5%, rather that the current maximum of 4%. This fiscal note assumes that the sales tax rate will remain at 4% in the state's constitution.

Fiscal Analysis

ASSUMPTIONS

Sales and Use Tax

1. This bill would impose a 4% general sales and use tax effective November 1, 2002. The tax would apply to all sales of goods and services except those specifically exempted.
2. Sales by or to governments and Indian tribes are exempt. Occasional sales are exempt. Sales for resale and sales of goods that will be leased are exempt. Payment of wages, interest, and dividends are not considered sales of goods or services.
3. Sales of the following goods and services are exempt: a) groceries, b) medicine and medical services, c) agricultural products, d) gambling, e) insurance, f) motor fuel, g) mineral interests and minerals, h) printed

materials, i) advertising, j) day care, k) feed, fertilizers, and other ag inputs, l) chemicals used in mineral industries, m) mining and manufacturing equipment and the services of mining and manufacturing, and n) real estate and mobile homes.

4. Taxable sales are projected to be **$9,385,131,000** in fiscal 2003 and $14,781,582,000 in fiscal 2004. Tax liability is **$375,405,000** in fiscal 2003 and $591,263,000 in fiscal 2004.
5. Vendors are allowed to retain 1.5% of collections to defray their costs. Collections will be reduced another 5% because of bad debts to vendors and non-compliance. Collections will be **$351,004,000** (93.5% of $563,108,000) in fiscal 2003 and $552,831,000 (93.5% of $591,263,000) in fiscal 2004.

Individual Income Tax

6. This bill would repeal the individual income tax effective January 1, 2003. This would have no impact on fiscal year 2002 revenues; however, there will be a revenue impact in fiscal year 2003.
7. Withholding and quarterly estimated tax payments that would be paid under current law between January 1, 2003 and June 30, 2003 (the second half of fiscal 2003) representing pre-payments of calendar year 2003 tax liabilities would not be paid under this bill. On average, withholding and quarterly estimated tax payments paid during the course of a fiscal year represent 98% of all individual income tax revenue collected during the year. In addition, 57% of all withholding and quarterly estimated tax payments are collected in the second half of the fiscal year (between January 1 and June 30). Under current law, individual income tax collections for fiscal year 2003 will be $598,531,000 (HJR2). Based on these assumptions, individual income tax revenue will be reduced a total of $334,339,400 in fiscal year 2003 ($598,531,000 X 98% X 57% = $334,339,400).
8. Under current law, individual income tax collections will be $626,848,200 (DOR) in fiscal year 2004; under this bill, collections from individual income taxes will be zero in fiscal 2004 and in all subsequent fiscal years.

Property Tax

9. There are no property tax impacts under this bill under the assumption that the constitutional maximum sales tax rate is not changed from 4% through the referendum process.

Corporation License Tax

10. Beginning January 1, 2003 this bill changes the definition of "corporation" for the purposes of Title 15, Chapter 31 (the corporation license tax) to include: limited liability companies, limited liability partnerships, partnerships, sole proprietorships, and small business corporations (subchapter-S corporations). Under current law these "pass-through entities" allocate income to individual shareholders who then must include their gains and losses in income for individual income tax purposes. Under this bill, this net income that previously would have been reported for individual income tax purposes will now be reported as income subject to the corporation license tax at a tax rate of 6.75%. There is no impact from this part of the bill in either fiscal 2002 or fiscal 2003; there will be a full year impact in fiscal 2004 when these entities first file a tax return for corporation license tax purposes.
11. For fiscal year 2004, taxable income from sole proprietorships subject to the corporation license tax will be $623,518,000 (based on forecasts of schedule C income for current law individual income tax forecasting purposes). Taxable income from LLCs, LLPs, partnerships, and small business corporations will be $498,979,000. (This figure is based on the forecast of income reported on the individual income tax return for the line that includes rents, royalties, and income from pass-through entities, and assumes that half of this income is from pass-through entities.) At a tax rate of 6.75%, additional income from the corporation license tax will total $75,768,500 in fiscal 2004 ($623,518,000 + $498,979,000 = $1,122,497,000 X 6.75% = $75,768,500).

Administrative Impacts

12. If the provisions of this bill are approved by voters in the November 2001 election, the Department of revenue will be required to implement the sales and use tax July 1, 2002. To meet this schedule, the department would need to begin preparing to implement the sales and use tax immediately. The department would need to adopt administrative rules, develop forms, develop a new data processing system, and register and educate merchants. Thus, the department will incur additional costs in fiscal 2002 whether the referendum passes or fails.
13. The net impact on Department of Revenue administration expenses from implementing the new sales and use tax, eliminating the individual income tax, and providing for processing and audit of approximately and additional 100,000 corporation license tax returns would be $6,712,572 in fiscal 2002 and $7,844,971 in fiscal 2003. The Department of Revenue would phase out its existing income tax administration activities beginning in fiscal 2004.

Department of Fish, Wildlife, and Parks

14. Without the provision of a nongame check-off on the Montana Individual Tax Form, no donations will be made to the nongame wildlife account. Approximately $12,000 of revenue will be lost annually.

Secretary of State

15. The cost to conduct a general election is $894,067.
16. The cost to print the Voter Information Pamphlet is $108,500

FISCAL IMPACT:

	FY2002 Difference	FY2003 Difference
FTE	48.00	173.00
Expenditures:		
Personal Services	$1,343,233	$3,515,555
Operating Expenses	$5,473,195	$3,264,902
Equipment	$522,247	$380,385
Benefits	$376,464	$684,129
TOTAL	$7,715,139	$7,844,971
Funding:		
General Fund (01)	$7,715,139	$7,844,971
Revenues:		
General Fund (01) – Income Tax	$0	$(334,339,400)
General Fund (01) – Sales Tax	$0	$351,004,000
State Special – DFWP	$0	$(12,000)
Net Impact to Fund Balance (Revenue minus Expenditure):		
General Fund (01)	$(7,715,139)	$8,819,629
State Special Revenue (02)	$0	$(12,000)

LONG-RANGE IMPACTS:

The first full year of impacts from this proposal will be fiscal year 2004. The following table shows the net impact on revenue from this bill for fiscal year 2004:

Sales and Use Tax (4%)	$ 552,831,000

Individual Income Tax	$(626,848,200)
Corporation License Tax	$ 75,768,567
Net Revenue Impact	$ 1,751,367

With the repeal of the individual income tax, the department of revenue would phase out collections, refund, and audit activity related to this tax beginning in fiscal 2004. At the same time, the department would begin processing more corporation license tax returns. Compared to fiscal 2003, the department's costs would be $1,127,027 lower in fiscal 2004; $1,400,435 lower in fiscal 2005; and $1,614,083 lower in fiscal 2006.

TECHNICAL NOTES:

Department of Revenue

1. This bill would require the Department of Revenue to develop and implement systems to administer a completely new tax. The department would have to develop tax forms, non-taxable transaction certificates, and a new computer system; hire and train new employees and retrain existing employees; adopt administrative rules; and register and educate businesses. This cannot be done in the twelve months between the referendum required by section 160 and the applicability date in section 158(1). The department would need to begin preparing to implement the sales and use tax immediately, without waiting for the referendum. The very earliest that the Department of Revenue could implement a general sales and use tax is January 1, 2003.
2. Section 156(2)(a) specifies that, if HB635 is not approved by the electorate, then subsection 63(4) is void. This has two effects. It retains all sales and use tax revenue at the state level instead of distributing part to local jurisdictions, and it leaves all the revenue in a special revenue account rather than transferring it to the general fund. The rest of section 63 implies that the special revenue account is to be a temporary holding account. If that is the intent, Section 157(2)(a) should be changed. The fiscal note reflects distribution as though subsection 63(4) were not void.
3. The bill provides for implementation of a general sales and use tax beginning November 1, 2002 at a rate of 4%. Section 156, which provides coordination instructions, says that if the companion referendum increasing the constitutional maximum sales tax rate to 5% is approved then the sales tax rate is changed to 5% on *January 1, 2003*. Since the referendum would be voted on in November of 2001, it would be just as easy to change the sales tax rate to 5% beginning November 1, 2002. Not doing so would require a general sales tax to be in place at the rate of 4% for just two months, and then require the Department and all businesses to revise their computer systems to accommodate a change in the rate after only two months.

Department of Labor and Industry

4. The bill repeals 15-30-257 MCA Special review procedure for certain tax issues that involve unemployment insurance benefit claim – notice – appeal. Department of Revenue statutes 15-1-211 Uniform dispute review procedure – notice – appeal and 15-2-302 Direct appeal from department decision to state tax appeal board – hearing will remain under this bill. By removing 15-30-257, certain definitions related to the unemployment insurance appeals process will no longer be in DOR statutes. The process and timeframes (which correspond to the timeframes for appeals on the UI benefits side) listed in this statute relating to UI wage and employment appeals will also be lost. Perhaps these items could be put into a DOR rule, but they currently are not.

1. Under this bill in 15-2-302, the text which relate to UI issues have been removed. Again, this removes some timeframes and current procedures