# FISCAL NOTE

**Bill #:** SB0121 **Title:** Revise taxation of pass-through entities

**Primary Sponsor:** Glaser, B **Status:** As Introduced

Sponsor signature Date Chuck Swysgood, Budget Director Date

## Fiscal Summary

| | FY 2004 **Difference** | FY 2005 **Difference** |
|---|---|---|
| **Revenue:** | | |
| General Fund | $50,000 | $200,000 |
| **Net Impact on General Fund Balance:** | $50,000 | $200,000 |

| | |
|---|---|
| ☐ Significant Local Gov. Impact | ☐ Technical Concerns |
| ☐ Included in the Executive Budget | ☒ Significant Long-Term Impacts |
| ☐ Dedicated Revenue Form Attached | ☐ Needs to be included in HB 2 |

## Fiscal Analysis

**Discussion – House Bill 143 – 2001 Legislative Session**

HB143, passed during the 2001 Legislative Session, generally revised and clarified the reporting of income for pass-through entities (PTEs) and owners. It clarified that partnerships, S corporations, and other forms of "disregarded entities" are not subject to either individual or corporate income taxes; but also provided that partners, shareholders, and other owners of partnerships, S corporations, or other "disregarded entities", whether resident or nonresident, that have Montana source income are required to include their distributive shares of income when filing a Montana income tax return. Any PTE receiving Montana source income was required to file an information return providing the names of owners, each owner's distributive share of Montana source income, and other pertinent information required by the Department. HB143 contained an enforcement mechanism (consent agreements/composite returns/or withholding) that applies only to *nonresident individuals*.

PTEs could file "composite returns", and paying a composite tax on behalf of all participants, where "participants" included nonresident individuals consenting to be included in the composite filing. The bill detailed the PTE's responsibilities in this area, and provided the methodology for determining the tax liability.

For those nonresident individuals not included in a composite return, PTEs were allowed to file a "consent agreement" signed by the owner under which the owner consented to file a return, timely pay all taxes due the state, and be subject to the personal jurisdiction of the state for the collection of taxes.

Finally, for those nonresident individuals not included in either a composite return or a consent agreement, the PTE was required to "withhold" tax on the owner's distributive share of Montana-source income calculated at the highest marginal tax rate in effect at the time of the withholding. PTEs were entitled to recover these payments from the nonresident owner.

**Discussion – Senate Bill 121**

HB143 included an enforcement mechanism for the taxation of PTE Montana-source income with respect to resident and non-resident *individuals*. However, current law does not specifically address the enforcement mechanism for "tiered" pass-through entities; that is, PTEs that are owned by other PTEs. SB121 essentially extends the concepts and options provided for in HB143 for non-individual owners of entities specifically to owners that are corporations and themselves PTEs. These entities would be provided with the same options provided individuals, including 1) filing of composite returns; 2) filing of consent agreements (C corporations only, as PTE owners are not "taxpayers"); or 3) withholding. The bill expressly extends application of the state's tax laws through intervening PTEs to the ultimate taxpayer(s).

Amounts remitted through withholding for an individual or a C corporation would be credited directly to their accounts. PTEs making remittances for PTE owners (i.e., a PTE owning an interest in another PTE) would be provided with a tax credit equal to the amount of the remittance. To protect taxpayers from the possibility of double taxation, the distributive share of this credit would be passed through successive PTEs until it reached the ultimate individual taxpayer, who would be entitled to a "refundable" credit equal to the distributive share of the initial credit.

**Revenue Impact**

This bill will increase state general fund revenue. However, the Department of Revenue has no reliable means of estimating the impact that this bill will have on general fund revenues. This fiscal note provides a best guess estimate of $200,000 per year in the very first years of implementation. We anticipate that this amount will increase over time as taxpayer awareness and enforcement mechanisms are increased and put in place. Because there is no effective date on the bill as introduced, it is assumed that the bill will be effective October 31, 2003. The impact in fiscal year 2004 is anticipated to be $50,000 with this amount growing to $200,000 in fiscal year 2005.

There are no administrative impacts associated with this bill.

FISCAL IMPACT:

| | FY 2004 Difference | FY 2005 Difference |
|---|---|---|
| Revenues: | | |
| General Fund (01) | $50,000 | $200,000 |
| | | |
| Net Impact to Fund Balance (Revenue minus Funding of Expenditures): | | |
| General Fund (01) | $50,000 | $200,000 |

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

No impact.

LONG-RANGE IMPACTS:

The revenue impact from this bill is anticipated to increase in future fiscal years.