SENATE FINANCE AND CLAIMS
EXHIBIT NO. 1
DATE 3-17-05
BILL NO. SB 66

# INVESTMENT TAX CREDIT

## Senate Bill No. 66

Prepared by
Senator Kitzenberg

# FISCAL NOTE

**Bill #:** SB0066 **Title:** Investment tax credit

**Primary Sponsor:** Kitzenberg, S **Status:** As Amended in Senate Committee - 2nd Amendments

Sponsor signature Date David Ewer, Budget Director 2/19/05 Date

## Fiscal Summary

| | FY 2006 Difference | FY 2007 Difference |
|---|---|---|
| **Expenditures:** | | |
| General Fund | $0 | $35,023 |
| **Revenue:** | | |
| General Fund | $0 | ($494,200) |
| **Net Impact on General Fund Balance:** | $0 | ($529,223) |

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

## Fiscal Analysis

ASSUMPTIONS:

1. For tax years beginning after December 31, 2005, this bill would allow a credit against personal income tax or corporate license tax equal to 3% of qualified investment expenditures not to exceed 45% of the taxpayer's tax liability.
2. Businesses will be eligible for this credit only to the extent that they hire new employees. There are no restrictions on the amount of wages that must be paid to these new employees. The amount of investment eligible for the credit is limited to $100,000 for each new employee hired. For example, if a business invests $100,000 in new equipment and hires one person to operate that equipment the employer would be allowed a tax credit of $3,000 ($100,000 in new capital investment X 3% credit).
3. In addition, only small businesses with total assets of $5 million or less in the year in which the credit is claimed are eligible to receive the credit.
4. The state of Idaho has an investment credit similar to the one proposed in SB 66, except that the Idaho credit does not cap eligible investment at $100,000 for each new employee added; in Idaho the credit is available regardless of whether new employees are added or not. In Idaho, taxpayers are allowed an investment credit of 3% of qualified investments (the same property as in this bill) up to 50% of the taxpayer's liability, with a 7-year carryover period.



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5. In Idaho, over the period 1997 to 2003, corporations claimed an annual average of $15.020 million in investment credits, and individuals claimed an annual average of $9.148 million in investment credits.
6. The 1997 economic census reports capital expenditures for selected industries. Reported capital expenditures in Montana were 36.2% of capital expenditures in Idaho.
7. If the Montana credit were patterned strictly after the Idaho credit, the ratio of investment tax credits claimed in Montana to that claimed in Idaho would be the same as the ratio of capital expenditures in Montana to capital expenditures in Idaho. Individuals would claim investment tax credits of $3.312 million each tax year (36.2% x $9.148 million) and corporations would claim credits of $5.437 million each tax year (36.2% x $15.020 million).
8. However, the additional employment-related restriction, and limiting the credit to small businesses with less than $5 million of assets, will act to significantly reduce the amount of credit claimed in Montana. For the purposes of this fiscal note, it is assumed that the employment-related and asset size restrictions on the credit will reduce the amount of credit claimed to one-tenth of the above amounts that would be claimed without the restriction. Individuals will claim investment tax credits of $331,000 each tax year (36.2% x $9.148 million x 10%) and corporations will claim tax credits of $544,000 each tax year (36.2% x $15.020 million x 10%).
9. Credits against individual income tax would first be claimed on returns for tax year 2006, filed during FY 2007. A full year's worth of credits would be claimed, reducing income tax revenue in FY 2007 by $331,000.
10. For 30% of corporations, returns for the first tax year when this credit could be claimed would be filed in May and June of 2007. For 70% of corporations, the first return when this credit could be claimed would not be filed until FY 2008. Corporation license tax revenue in FY 2007 would be reduced by $163,200 (30% x $544,000).
11. General fund revenue in FY 2007 would be reduced by $494,200 ($331,000 + $163,200).
12. Because of the significance of this credit, the Department of Revenue would require an additional 0.50 FTE for individual income tax compliance work and an additional 0.25 FTE for corporation license tax compliance work beginning in FY 2007. The additional cost in FY 2007 would be $35,023. No changes to the department's computer systems would be required.

FISCAL IMPACT:

| | FY 2006 Difference | FY 2007 Difference |
|---|---|---|
| FTE | | |
| Expenditures: | | |
| Personal Services | | $23,423 |
| Operating Expenses | | $[illegible] |
| Equipment | | $11,600 |
| TOTAL | | $35,023 |
| Funding of Expenditures: | | |
| General Fund (01) | | $35,023 |
| Revenues: | | |
| General Fund (01) | | ($494,200) |
| Net Impact to Fund Balance (Revenue minus Funding of Expenditures): | | |
| General Fund (01) | | ($529,223) |

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
None.

LONG-RANGE IMPACTS:
FY 2008 is the first fiscal year when the full impact of the credit on corporation license tax would be felt. Credits claimed in FY 2008 and following years will be $875,000 ($331,000 against individual income tax and $544,000 against corporation license tax).

45% of the taxpayer's liability would likely spread the negative impact over a period of years – from one to seven based upon the ability to carry the unused credit forward for 7 years.

FISCAL IMPACT:

| | FY2006 Difference | FY2007 Difference |
|---|---|---|
| FTE | | .50 |
| Expenditures: | | |
| Personal Services | | $15,595 |
| Operating Expenses | | 7,828 |
| Equipment | | 11,600 |
| TOTAL | | $35,023 |
| Funding: | | |
| General Fund (01) | | $35,023 |
| TOTAL | | |
| Revenues: | | |
| General Fund (01) | **(see assumptions #3-9)** | $0 |
| Net Impact to Fund Balance (Revenue minus Expenditure): | | |
| General Fund (01) | | ($35,023) |

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

The creation of jobs in a community may result in positive impacts, such as increasing the tax base.

LONG-RANGE IMPACTS:

Because of the delayed implementation date of this bill, the full impact of this proposal for both the individual income tax and corporation license tax will not occur until fiscal 2008. It is estimated that in FY 2008, the credit provided for in this bill will reduce corporation tax revenue by $0.544 million and will reduce individual income tax liabilities by $0.331 million, for a total reduction in revenue of $0.875 million. Assuming that investments continue at the same level, impacts of this magnitude will continue in subsequent years. As indicated in assumptions 3 through 7, there are expected to be positive revenue impacts that would offset the loss of revenue, if not in the first year then over a period of years.

Fiscal Note Prepared by: Sen. Sam Kitzenberg

# Attachment

Figure 1
Example of Income-Multiplier Effect

| A | B | C | D | E | F | G |
|---|---|---|---|---|---|---|
| Worker | Before tax income including benefits | Spending (70% of income) | Local spending (90% of spending) | Wholesale purchases outside region (34.9% of local spending) | Purchases or wages paid inside region | Percent Column G is of Column B |
| 1 | 35,000 | 24,500 | 22,050 | 7,695 | 14,355 | 41.0% |
| 2 | 14,355 | 10,048 | 9,043 | 3,156 | 5,887 | 41.0% |
| 3 | 5,887 | 4,121 | 3,709 | 1,294 | 2,415 | 41.0% |
| 4 | 2,415 | 1,690 | 1,521 | 531 | 990 | 41.0% |
| 5 | 990 | 693 | 624 | 218 | 406 | 41.0% |
| 6 | 406 | 284 | 256 | 89 | 167 | 41.0% |
| 7 | 167 | 117 | 105 | 37 | 68 | 41.0% |
| 8 | 68 | 48 | 43 | 15 | 28 | 41.0% |
| 9 | 28 | 20 | 18 | 6 | 11 | 41.0% |
| 10 | 11 | 8 | 7 | 3 | 5 | 41.0% |
| Total | 59,327 | | | | | |

Note: The "multiplier" is 1.7 (59,327 divided by 35,000)

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# REVISED SPONSOR'S FISCAL NOTE

**Bill #:** SB 66 **Title:** Investment tax credit

**Primary Sponsor:** Sam Kitzenberg **Status:** As amended in Senate committee

Sam Kitzenberg 2-22-05
Sponsor signature Date

## Fiscal Summary

The purpose of this fiscal note is to demonstrate that the revenue impact of an investment tax credit as proposed in SB 66 has two sides. The original fiscal note shows only one side (the loss of revenue from the tax credit). Because the purpose in implementing an investment tax credit is to encourage investment that in turn results in new jobs, this fiscal note provides a scenario to demonstrate the positive revenue impacts as well the revenue loss from application of the credit. As amended, the bill provides that the amount of investment that qualifies for the credit must be $100,000 for each additional full-time employee, and the credit is subject to recapture if the new position is not filled for at least 3 years. The amendment also limits the tax credit to businesses with $5 million or less in assets in the year for which the credit is claimed.

| | FY2004 Difference | FY2005 Difference |
|---|---|---|
| **Expenditures:** | | |
| General Fund | | $35,023 |
| **Revenue:** | | |
| General Fund | | $0 |
| **Net Impact on General Fund Balance:** | | **($35,023)** |

| 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 | | Needs to be included in HB 2 |

Sponsor's FN #2
SB 66

## Fiscal Analysis

ASSUMPTIONS:

1. The credit of 3 percent on qualified investments is effective January 1, 2006, which means that the tax credit sought for investments made beginning in calendar year 2006 will be included in returns filed in the first half of calendar year 2007 (which is the last half of fiscal year 2007) and years thereafter.
2. This "Sponsor's Fiscal Note" assumes that the fiscal impact of the executive's fiscal note is accurate to the extent that it shows the Department of Revenue cost of implementation and the direct negative revenue impact that occurs with application of the credit in individual and corporate tax returns. The revised executive fiscal note shows the cost of implementation to be $35,023 in the second year of the biennium. The reduction in general fund revenue resulting from the credit is shown to be $494,200 in the second year and $875,000 annually in subsequent years. This assumes that filings for the credit will occur beginning in the second half of the second year. The executive's fiscal note assumes that 100% of the credits taken in individual returns will occur in this period. It assumes that 30% of the credits taken in corporate returns will occur in this time period, resulting in a partial impact in the second fiscal year of the biennium and then a full impact in subsequent years.
3. The estimated investment applied to the credit in fiscal year 2007 is $16.5 million and in fiscal year 2008 would be $29.2 million. (Divided DOR revenue loss estimates by 3%.)
4. New jobs will be created as a result of business investments. For purposes of this fiscal note, it is assumed that the average salary plus benefits for new jobs would be $35,000 per year.
5. The "multiplier effect" for creation of new jobs would be 1.7. This means that an investment in the economy results in an additional 70 percent created elsewhere in the economy as those moneys cycle through the economy. Another way to look at this is that 41% of the $35,000 income is spent in the local economy, and 41% of that portion is spent in the local economy, and so on. If continued through 10 iterations, the result is that the total amount of impact in the local economy is $59,327 (1.7 times $35,000). A table is attached that demonstrates the model used.
6. The tax liability (gain in tax revenue) attributable to the new position would be $1,402 assuming a 20% deduction, $2,505 for exemptions, and a 5.5% tax rate. Applying the 1.7 multiplier results in an estimated tax liability of $2,376 resulting from the overall impact of adding the one job.
7. Dividing $2,376 by the investment tax credit rate of 3% indicates that a job would need to be created for each $79,200 of investment in order to offset the loss of revenue (resulting from the credit) in the year that the credit is taken. For fiscal year 2007, if the job lasted only one year, the number of jobs created would need to be 208. Similarly, in fiscal year 2008, the number of jobs created would need to be 369.
8. However, the impact of a job created would occur every year that the new job continues to be in place and filled.
    a. If the average life of new jobs were 7 years, then only about 30 jobs would need to be created in fiscal year 2007, and 53 jobs would need to be created in fiscal year 2008. This translates to the need for one new job for every $550,000 in investment.
    b. If the average life of new jobs were 3 years, then about 70 jobs would need to be created in fiscal year 2007, and 123 jobs would need to be created in fiscal year 2008. This translates to the need for one new job for every $237,600 in investment.
9. However, this would mean that the negative impact of the credit could occur in one year and the positive impact would occur over a period of seven years. The fact that the tax credit cannot exceed

Summary of Senate Bill No. 66, 2nd Reading Copy

Section 1: Allows persons filing individual income taxes to use the same provisions as corporate license taxes that are set out in section 2.

Section 2:
Provides an investment tax credit for small businesses.
The credit is equal to 3% of employment-adjusted qualified investments, not to exceed 45% of tax liability.
Qualified investments are depreciable property (personal property, not real estate) and not light vehicles. The investment property must be located in Montana..
The taxpayer must be a small business -- less than $5 million in total assets.
The employment adjustment is:

Investments are limited to $100,000 for each new full-time 3-year employee.

All or part of a credit may be recaptured for failure to keep employee for the 3 years.

Credit may be carried forward for 7 years.
If the investment property is moved or sold, the credit, or part of it, can be recaptured.
The credit sunsets in 2016.

Section 3:
The department of revenue must report on the credit to the Revenue and Transportation Interim Committee.

Sections 5 and 6.
The credit begins for property purchased after December 31, 2005.

- This Bill creates an investment tax credit for small businesses that invest in new equipment in order to create new jobs
- The credit is available only if new employment is created. For each new job, the small business can claim a credit of 3% of the cost of the new capital investment up to a cap of $100,000.
- As an example, if a print shop invested in a $250,000 piece of equipment that resulted in two new jobs, the small business could claim a credit of 3% on $200,000 of the $250,000 invested for a net calculated credit of $6,000 against the small businesses income tax.
- This tax credit is subject to recapture if the new employment ends within the first three years.

We need to recognize the importance of small business in job creation in this state. Small business accounts for 92% of the new jobs in Montana. This bill provides an economic incentive for out local business owners to invest in new equipment needed to create new jobs. The short term cost of this new credit will be made up in the long run by an increased tax base from the new job creation.

SENATE BILL NO. 66

INTRODUCED BY S. KITZENBERG

A BILL FOR AN ACT ENTITLED: "AN ACT PROVIDING FOR A GENERAL INVESTMENT TAX CREDIT; PROVIDING THAT A 3 PERCENT CREDIT FOR QUALIFIED INVESTMENTS IS ALLOWED AGAINST INDIVIDUAL INCOME TAXES OR CORPORATE LICENSE TAXES; LIMITING THE INVESTMENT CREDIT IN ANY 1 YEAR TO NO MORE THAN 45 PERCENT OF THE TAXPAYER'S TAX LIABILITY; PROVIDING FOR A 7-YEAR CARRYOVER OF UNUSED INVESTMENT CREDITS IF THE UNDERLYING INVESTMENT REMAINS IN MONTANA; AND PROVIDING A DELAYED EFFECTIVE DATE AND AN APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 1. Investment credit.** There is allowed an investment tax credit against the taxes imposed by 15-30-103 in an amount determined in [section 2].

NEW SECTION. **Section 2. Investment credit.** (1) There is allowed an investment tax credit against the taxes imposed by 15-31-101, 15-31-121, and 15-31-122.

(2) The credit is an amount equal to:

(a) the investment credit carryovers; and

(b) the investment credit for the tax year.

(3) An investment qualifies for a credit if:

(a) the investment is depreciable property under sections 46(c) and 48 of the Internal Revenue Code of 1986, 26 U.S.C. 46(c) and 48, as those sections read prior to November 5, 1990, subject to the limitations provided for certain regulated companies in section 46(f) of the Internal Revenue Code of 1986, 26 U.S.C. 46(f), as that section read prior to November 5, 1990, and if the property is not a motor vehicle under 8,000 pounds gross weight;

(b) the property was placed in service in Montana; and

(c) the property was used, acquired, constructed, reconstructed, erected, or placed into service after December 31, 2005.

(4) (a) The amount of the investment credit for a tax year is 3% of the amount of qualified investments

1 made during the tax year. The investment credit allowed for the tax year may not exceed 45% of the tax liability
2 of the taxpayer for that year.
3 (b) If the sum of investment credit carryovers and the amount of credit for the tax year from the credit
4 allowed by subsection (1) exceeds the limitation imposed by subsection (4)(a) for the current tax year, the
5 excess attributable to the current tax year's credit is an investment credit carryover to the 7 succeeding tax years.
6 The entire amount of unused credit must be carried forward to the earliest of the succeeding years, and the
7 oldest available unused credit must be used first. The investment credit carryover may be used only as long as
8 the qualified investment property for which the unused credit was granted remains in Montana.
9 (5) If property for which an investment credit is claimed is used both inside and outside this state, only
10 a portion of the credit is allowed. The credit must be apportioned according to a fraction, the numerator of which
11 is the number of days during the tax year that the property was located in Montana and the denominator of which
12 is the number of days during the tax year that the taxpayer owned the property. The investment credit may be
13 applied only to the tax liability of the taxpayer who purchases and places in service the property for which an
14 investment credit is claimed.
15 (6) The investment credit allowed by this section is subject to recapture as provided for in section 50
16 of the Internal Revenue Code, 26 U.S.C. 50. A recapture of the credit allowed by this section is not required with
17 regard to property ceasing to qualify by reason of an involuntary conversion within the meaning of section 1033
18 of the Internal Revenue Code, 26 U.S.C. 1033.
19 (7) If a small business corporation, as defined in 15-30-1101, qualifies for the credit provided for in this
20 section, the credit must be attributed to the shareholders based upon the proportion used to report the
21 corporation's income or loss for Montana income tax purposes.
22 (8) An investment credit claimed under this section may be claimed after any other tax credit to which
23 the taxpayer may be entitled.
24
25 NEW SECTION. **Section 3. Codification instruction.** (1) [Section 1] is intended to be codified as an
26 integral part of Title 15, chapter 30, and the provisions of Title 15, chapter 30, apply to [section 1].
27 (2) [Section 2] is intended to be codified as an integral part of Title 15, chapter 31, and the provisions
28 of Title 15, chapter 31, apply to [section 2].
29
30 NEW SECTION. **Section 4. Effective date.** [This act] is effective January 1, 2006.

1

2 NEW SECTION. **Section 5. Applicability.** [This act] applies to tax years beginning after December

3 31, 2005.

4 - END -