

FISCAL NOTE

Bill #: SB0513

Title: Assure the accurate determination and collection of Montana taxes

Primary Sponsor: Elliott, J

Status: As Introduced

Sponsor signature

Date

David Ewer, Budget Director

Date

Fiscal Summary

	<u>FY 2006 Difference</u>	<u>FY 2007 Difference</u>
Expenditures:		
General Fund	\$0	\$0
Revenue:		
General Fund	\$9,700,000	\$8,600,000
Net Impact on General Fund Balance:	\$9,700,000	\$8,600,000

- | | |
|---|---|
| <input type="checkbox"/> Significant Local Gov. Impact | <input type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input checked="" type="checkbox"/> Significant Long-Term Impacts |
| <input type="checkbox"/> Dedicated Revenue Form Attached | <input type="checkbox"/> Needs to be included in HB 2 |

Fiscal AnalysisASSUMPTIONS:

- 1) This bill provides for major new income and corporate license tax compliance measures for the State of Montana. Different sections of the bill address various means by which taxpayers are taking advantage of the tax system by engaging in abusive tax transactions and by not paying taxes on income earned in Montana and properly taxable in Montana. This bill also addresses shortcomings in the current tax code that may allow income to escape taxation.
- 2) **Sections 1 through 9**, which may be cited as the "*Tax Abuse, Avoidance and Evasion Reporting Act*", address abusive tax transactions by:
 - a) requiring taxpayers to report abusive transactions (based in general on federal reporting requirements);
 - b) requiring "material advisors" to disclose additional information, including a list of clients to whom the transaction was sold;
 - c) requiring taxpayers to disclose when information provided to other states is not consistent with information reported to Montana;
 - d) requiring companies soliciting business in Montana to disclose information pertinent to determining legal nexus with Montana for taxation purposes;
 - e) imposing substantial penalties on persons failing to comply with these requirements; and

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- f) implementing a voluntary compliance initiative that allows persons to avoid penalties by reporting abusive tax transactions and paying tax and interest before March 31, 2006.
- 3) These sections are modeled on California's abusive tax shelter amnesty program. California received approximately \$1.4 billion from a four-month tax shelter amnesty from December 2003 through March 2004.
- 4) Montana's gross state product is 1.76% of California's. (Montana's population and personal income are 2.59% and 2.00% of California's.) Scaling the results of California's amnesty program to Montana using the ratio of gross state product gives \$24 million. To account for differences between the states and unknown factors that might lead to different results in the two states, it was assumed that Montana's amnesty program would be one-fifth as successful as California's, producing \$4.8 million in additional revenue in FY 2006.
- 5) In FY 2007, \$3.2 million is estimated for continuing post-amnesty enforcement work. That estimate is based on the size and number of tax shelter cases the department has identified from limited information sharing from other states (approximately 137 cases at this point) and, more generally, from the enforcement experience of the IRS and other states. For example, the Department of Revenue has discovered a single case of abusive tax sheltering that will likely yield over \$800,000 of revenue to the state.
- 6) No revenue is attributed to the inconsistent reporting and nexus information provisions. Significant revenues will result from these provisions. For example, the Department of Revenue has identified through an audit a case of inconsistent reporting by a multijurisdiction corporation that will yield an expected \$4 million in revenue. The provisions of the bill will result in systematic reporting by corporations that will be much more effective than current auditing procedures in identifying these inconsistencies. Similarly, identifying non-filing corporations can yield major results in specific cases. However, revenue will vary substantially from case to case and year to year.
- 7) **Sections 10 through 12**, which may be cited as the "Real Estate Backup Withholding Act" address the proper reporting and collection of tax on income earned in Montana by requiring withholding on the transfer of Montana real estate by a nonresident individual or foreign entity in an amount equal to the lesser of (a) 2.5% of the sales price, or (b) the amount of certified gain multiplied by the highest marginal individual income tax rate in effect at the time (with certain transfers exempt as provided for in the bill). The department has tested this concept by doing limited test audits of sales of bare land in Ravalli County. In this limited review, the department identified nine cases of non-residents failing to pay income taxes on gains from the sale of land, yielding approximately \$200,000 in revenue. Statewide revenue from applying these provisions to all real estate sales would yield much more revenue.
- 8) Maryland has similar legislation in place which results in additional net revenue of \$28.8 million per year. The results of the Maryland program were adjusted to Montana by multiplying by the ratio of the value of real property in Montana to the value of real property in Maryland and then adjusting for the difference in the percentage of non-resident filers in the two states. (Montana real property is 12% of the value of Maryland real property. Non-residents are 15% of the Maryland tax base and 10% of the Montana base.) This yields an annual revenue estimate of \$2.4 million in revenue or \$4.8 million for the biennium.
- 9) **Sections 13 through 26** of the bill address a variety of 1) areas of confusion in current law that can result in incorrect reporting; and 2) specific tax avoidance concerns dealing with the appropriate taxation of income earned in Montana but currently escaping taxation., including:
 - a) *For S. Corporations:*
 - i) imposing a tax at the rate of the regular corporation license tax rate provided for at 15-31-121(1), currently 6.75%, on the net recognized "built-in gain" of S. Corporations, as determined under section 1373 of the Internal Revenue Code (Section 13); and
 - ii) conforming to federal law treatment of S corporation shareholders that are "electing small business trusts" or tax-exempt trusts (including employee stock ownership plans (ESOPS);

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- b) *For Regulated Investment Companies (RICs, also known as Mutual Funds)*: clarifying state law to include in Montana taxable income certain income receiving special tax treatment at the federal level that currently may not be reported as income for state purposes;
 - c) *For Real Estate Investment Trusts (REITs)*: clarifying the taxation of REITs by, among other things, disallowing a deduction for dividends paid by the REIT, while providing for an exclusion of the individual shareholder's portion of these dividends;
 - d) *For Insurance Companies*: imposing the corporation license tax on the non-insurance income of insurance companies.
 - e) Providing for increased penalties for violations of tax law.
- 10) Revenue from these provisions is estimated to be \$2.6 million in FY 2006 and \$2.9 million in FY 2007. This is based on actual taxpayer data taken from Montana returns for items covered by these sections. Because the review of actual returns was limited to certain items and to only the most likely affected taxpayers, it is a conservative estimate.
- 11) Overall, these provisions of this bill are anticipated to increase general fund revenue by \$18.3 million over the 2007 biennium, with \$9.7 million of this amount generated in FY 2006 and \$8.6 million generated in FY 2007.
- 12) There are no additional administrative costs to the Department of Revenue from this bill.

FISCAL IMPACT:

	<u>FY 2006</u> <u>Difference</u>	<u>FY 2007</u> <u>Difference</u>
<u>Revenues:</u>		
General Fund (01)	\$9,700,000	\$8,600,000
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>		
General Fund (01)	\$9,700,000	\$8,600,000

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

None.

LONG-RANGE IMPACTS:

The additional revenue will continue into future biennia, but will vary from year to year.

