FISCAL NOTE

Bill #:	SB0506	**Title:**	Simplify income tax
Primary Sponsor:	Cobb, J	**Status:**	As Introduced

Sponsor signature Date   David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund	$0	$0
Revenue:		
General Fund	($527,000)	($9,143,000)
Net Impact on General Fund Balance:	($527,000)	($9,143,000)

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

Fiscal Analysis

ASSUMPTIONS:

1. Beginning with tax year 2006, this bill would revise the manner in which Montana levies individual income tax. Currently, Montana ties its individual income tax to federal adjusted gross income (FAGI), and relies on state-determined personal exemption amounts, standard deduction amounts, and tax rate schedules. Under this proposal, the state's individual income tax would be tied directly to federal taxable income (FTI), thereby indirectly incorporating federal personal exemption and standard deduction amounts. Because the federal personal exemption and standard deduction amounts are significantly higher than those in current law, this proposal would act to remove between 40,000 and 45,000 low-income taxpayers and households from state individual income tax rolls.
2. This proposal would further require that, for individual income tax purposes, Montana taxpayers must use the same filing status (single, head of household, married filing jointly, etc.) as that used for federal income tax purposes. Currently, in Montana two-earner married couples are allowed to file separate tax returns. In tax year 2003, over 100,000 married couples chose this option. On the other hand, nearly all (98-99%) married couples in Montana file joint federal income tax returns, and would do so for state purposes under this bill. Consequently, because the ability to file separately is one of the most complicating features of current income tax law, this proposal would also act to greatly simplify income tax filing for Montanans and tax preparers.

3. This proposal ties Montana's individual income tax base to federal taxable income; but the bill also provides for the following adjustments to FTI to arrive at Montana taxable income (MTI), the tax base:

Federal Taxable Income

plus: Non-Montana state and local government interest

less: Interest on US government bonds
Railroad retirement
Tribal source income
Up to $4,700 of pension/annuity income, reduced by $2 for every $1 of FAGI over $60,000
Active duty military pay
Tip income
Unemployment compensation
Contributions to:
1. medical savings accounts
2. first-time homebuyer accounts
3. education savings accounts

Insurance premium payments for:
1. medical care
2. long-term care

Deposits to Montana farm/ranch risk management accounts

Equals: Montana taxable income

4. Under current law, all taxpayers, regardless of their filing status are subject to a single tax rate table with tax rates that range from 1% to 6.9%. Under the proposal, separate tax rate tables, patterned after federal tax rate tables, are provided for single filers, heads of households, married couples filing jointly, and married couples filing separate tax returns, the taxable income bracket boundaries and tax rates of which are as follows:

Single and Married Filing Separate		**Heads of Household**		**Married Filing Jointly**	
Taxable Income	Tax	Taxable Income	Tax	Taxable Income	Tax
0 to 3,000	4.0% of TI	0 to 4,800	4.0% of TI	0 to 6,000	4.0% of TI
3,000 to 13,000	5.0% of TI · $30	4,800 to 20,800	5.0% of TI · $48	6,000 to 26,000	5.0% of TI · $60
13,000 to 38,000	6.0% of TI · $160	20,800 to 60,800	6.0% of TI · $256	26,000 to 76,000	6.0% of TI · $320
38,000 and over	6.6% of TI · $388	60,800 and over	6.6% of TI · $621	76,000 and over	6.6% of TI · $776

5. The bill applies to tax years beginning after December 31, 2005 (tax year 2006). However, the full impact of tying to federal taxable income will not be felt in tax year 2006. Taxpayers who deduct their 2005 federal taxes in calculating their 2005 state taxable income will be required to report any refunds of 2005 federal taxes as income in 2006. With no deduction for federal taxes beginning in tax year 2006, taxpayers will no longer report federal refunds as income beginning in tax year 2007.
6. Based on Department of Revenue computer simulation models, it is estimated that this proposal will reduce full-year resident income tax liabilities by $7.159 million in tax year 2006, and by $16.075 million in tax year 2007.
7. The Department of Revenue will adjust withholding tables beginning January 1, 2006 to accommodate the changes provided for in this bill. Taxpayers also will adjust quarterly estimated tax payments to

accommodate the changes in this bill. This will result in a reduction of general fund revenue of $4.412 million in FY 2006 and $14.054 million in FY 2007.

8. The proposal also repeals a variety of individual and corporate tax credits. These credits, and the estimated fiscal impacts of eliminating them, are shown in the following table. Eliminating these credits is estimated to increase general fund revenues by $3.885 million in FY 2006 and $4.911 million in FY 2007.

Credits Eliminated in SB506

	INDIVIDUALS		CORPORATIONS		TOTAL CREDITS	
Credit Type	FY2006	FY2007	FY2006	FY2007	FY2006	FY2007
Energy Conservation Credit	3,000,000	4,000,000	0	0	3,000,000	4,000,000
Employer Disability Insurance Credit	80,000	90,000	7,000	7,000	87,000	97,000
University System Contribution Credit	160,000	156,000	6,500	6,500	166,500	162,500
Alternative Fuels Conversion Credit	3,200	3,200	5,000	5,000	8,200	8,200
Preservation of Historic Properties Credit	36,000	36,000	30,000	30,000	66,000	66,000
Empowerment Zone New Employees Credit	0	0	0	0	0	0
Geothermal Systems Credit	330,000	350,000	0	0	330,000	350,000
Alternative Energy Generation Credits	10,000	10,000	0	0	10,000	10,000
Recycling Credit	100,000	100,000	117,000	117,000	217,000	217,000
Utility Interest Differential Credit	0	0	0	0	0	0
Total Credits	3,719,200	4,745,200	165,500	165,500	**3,884,700**	**4,910,700**

9. This bill would have no administrative impacts to the Department of Revenue.
10. Based on the above assumptions, it is estimated that this bill will reduce general fund revenues by $527,000 in FY 2006, and by $9,143,000 in FY 2007.

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference
Revenues:		
General Fund (01)	($527,000)	($9,143.000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	($527,000)	($9,143.000)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

Effective beginning with tax year 2006, this bill also repeals MCA, 15-24-1401 and 1402, which eliminates the local government new and expanding industry property tax abatement program. This program is currently estimated to reduce property taxes a total of $1.66 million per year. This will act to increase revenues to local governments statewide by about $1.66 million, annually, in the absence of any mill levy changes.

LONG-RANGE IMPACTS:

Individual income tax revenues will continue to be reduced by $14-16 million annually under this bill, as introduced.

TECHNICAL NOTES:

1. The bill provides that the bracket boundaries of each of the separate tax rate tables provided for in the bill are to be indexed annually for inflation. It would be cleaner to follow the federal approach and set the bracket boundaries for heads of household equal to 80% of those for married couples filing jointly, and the

bracket boundaries for single filers and married couples who file separately equal to 50% of those for married couples filing jointly.

2. Because the definition of “inflation factor” in Section 11(12) of the bill was not amended from June 2005 to June 2006, the tax rate tables provided for in the bill will be indexed for one year’s worth of inflation in the first year for which the bill is effective (tax year 2006).
3. Section 21, amends 15-30-187, MCA (credit for donations to developmental disability services account) to provide that “A taxpayer claiming a credit under this section may not claim a deduction on the taxpayer’s federal return…”. Rather than specifying what a taxpayer may or may not do on their federal tax return, it would be more appropriate to provide (as is done in the previous section of the bill), that if the taxpayer claims a deduction on the federal return that the state credit must be reduced in some reasonable fashion for state tax purposes.