FISCAL NOTE

Bill #:	SB0517	**Title:**	Revise taxes --statewide general sales tax --property tax relief
Primary Sponsor:	Essmann, J	**Status:**	As Introduced

Sponsor signature Date   David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund	$3,080,906	$123,088,926
Revenue:		
General Fund	($4,524,989)	($8,201,104)
State Special Revenue	($285,789)	$12,285,649
Net Impact on General Fund Balance:	($7,605,895)	($131,290,030)

☒	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

ASSUMPTIONS:

Department of Revenue:

1. This bill provides for a general retail sales and use tax levied at a rate of 3%. The bill also provides for a local option sales tax that is tied to the state sales and use tax subject to approval by the local electorate. The current law class 8 exemption for business equipment is increased from $5,000 to $50,000. Households are provided with a credit against individual income tax liability to offset sales taxes. The bill provides for an “occasionally occupied residential property use fee” of 0.5% of the full market value of the property. The bill repeals the statewide 101 mills levied for schools and the general fund. This bill provides that if SB450 is not passed and approved then this act is void.

Property Tax – Elimination of the 101 Mills

2. This bill repeals the 95 mills levied for the state general fund and the 6 mills levied for the university system beginning January 1, 2006. Non-levy revenue associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts.

3. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not liened to real property pay property taxes 30-days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay sometime before April in the current fiscal year. Therefore, there are some FY 2006 impacts associated with the bill.
4. About 38% of personal property is identified as "personal property not liened to real property". In FY 2006, the estimated taxable value associated with this property is $47,631,468. In FY 2007, total statewide taxable value is estimated to be $1,852,941,477.
5. In FY 2006, the reduction in general fund revenue from eliminating the 95 mills is estimated to be $4,524,989 ($47,631,468 x 95.0 mills); in FY 2007 this revenue reduction is estimated to be $176,029,440 ($1,852,941,477 x 95.0 mills).
6. Estimated mill levy property tax loss to the university 6-mill account is estimated to be $285,789 ($47,631,468 x 6 mills) in FY 2006, and $11,117,649 ($1,852,941,477 x 6 mills) in FY 2007.
7. In addition to mill levy revenue loss, all other non-levy revenue associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts. This is estimated to reduce revenues to the state general fund by an additional $3,755,000 in FY 2007.
8. Non-levy revenues to the 6-mill university system account are reduced by an estimated $300,000 in FY 2007.
9. Total property tax revenue *loss* to the general fund as a result of eliminating the 95 mills levied for the general fund is estimated to be **$4,524,989** for FY 2006; and **$179,784,440** ($176,029,440 + $3,755,000) for FY 2007.
10. Total property tax revenue *loss* to the 6-mill university system account is estimated at **$285,789** for FY 2006, and **$11,417,649** ($11,117,649 + $300,000) for FY 2007.

Property Tax – Class 8 Business Equipment

11. Section 7 of the bill amends 15-6-138, MCA, changing the exemption for class 8 business equipment. Under current law, taxpayers with $5,000 or less of class 8 property are exempt from tax on that property. This bill would give all taxpayers an exemption equal to $50,000 effective January 1, 2007 (See technical note #1). This has no impact on the state general fund or the university system, as under this bill the mill levies for these accounts are repealed beginning in tax year 2006. (See local government and long term impact sections.)

Occasionally Occupied Residential Property Use Fee

12. Sections 63 through 72 provide for a new "occasionally occupied residential property use fee." Property subject to this fee would be levied a tax equal to 0.5% of the market value of the property.
13. According to the 2000 U.S Census of Housing, there are 24,213 seasonal, recreational, or occasional use housing units in Montana. Using a random sample of 24,213 dwellings from the Department's 2004 property tax database and excluding owner-occupied homes, mobile homes, vacant lots, and low-valued improvements (sheds, e.g.) provides an estimated full appraisal value of $3,705,667,221 for properties that would be subject to the new fee.
14. Payments of the occasionally occupied residential property use fee for all of tax year 2006 would be due by November 30. There would be no impact from the imposition of the fee in FY 2006. In FY 2007, revenues from the fee are estimated to be $18,528,336 ($3,705,667,221 * 0.5%). Section 64 (2) provides the full 2006 tax year fee payment be deposited in the state general fund. For succeeding years, one-half of the fee collections would be remitted to the state and the counties would retain one-half.

Sales Tax

15. Beginning January 1, 2007, this bill enacts a 3% general retail sales and use tax on tangible personal property and fees for sporting, recreation and sightseeing activities and rentals other than the base rental charge for rental vehicles, which would continue to be taxed under current statutes at the current law rate of 4%. The bill provides for the following exemptions: sales of real property and improvements; property or a service for resale; purchases by tribes or government; sales of utility services, including telecommunications services; unprepared food; prepared food that is part of a residential or health care arrangement; medicine, durable medical equipment, mobility enhancing equipment, and therapeutic and prosthetic devices; motor fuels; sales of used clothing; insurance premiums; dividends and interest; isolated or occasional sales; agricultural inputs; agricultural sales; sale or lease of mineral interests; sales of platinum or palladium; mining inputs; minerals; reagents used in the processing of ores or petroleum.
16. During the six months of FY 2007 when the sales tax would be in effect, taxable sales would be $5,432.675 million, and gross tax liability would be $162.980 million. In FY 2008, taxable sales would be $11,435.101 million, and tax liability would be $343.053 million. To control for noncompliance, it is assumed that vendors would remit taxes equal to 95% of tax liability. This reduces collections by $8.149 million in FY2007, and by $17.153 million in FY 2008.
17. There would be approximately 19,200 businesses collecting the tax on their sales. The bill provides for a vendor allowance according to the following schedule:

Sales	Vendor Allowance
For the first $1 million	6%
For the next $4 million	4%
For the next $5 million	3%
Over $10 million	0%

    Vendor allowances would total $5.428 million in FY2007, and $11.049 million in FY2008.

18. Total gross tax liability, adjusted for noncompliance and vendor allowances, would be remitted to the state. Net sales and use tax collections, before sales tax administration costs, would be **$149.403** million in FY2007 and **$314.851** million in FY2008. Sales tax revenue would be deposited in the general fund.

Individual Income Tax

19. Section 16 of the bill provides for a tax credit against individual income tax for sales and use tax paid. The taxpayer may choose among two alternative methods of determining the credit: the taxpayer may (1) document sales tax paid, up to certain maximum amounts; or (2) take a credit equal to 1.25% of the median amount of adjusted gross income reported on all full-year resident returns in the prior year, adjusted for certain items of income. This credit is not refundable; taxpayers with no individual income tax liability will not receive a credit under this approach. Also, the credit is not limited to taxpayers or households on the basis of income, but is available to all taxpayers and households regardless of income.
20. In tax year 2003, the median adjusted gross income reported on full-year resident returns was $19,360. A credit of 1.25% of this amount is equal to $242. It is assumed that the credit would be allowed for *each return* filed, regardless of whether the return is filed by the spouse of a taxpayer who also is filing a return (see Technical Note 6). In tax year 2003, allowing a credit equal to individual income tax liability up to $242 for every return filed would have reduced tax liability by $81 million. Half of this credit would have accrued to taxpayers and households with adjusted gross income of $45,000 or less and half of this credit would have accrued to taxpayers and households with incomes over this amount. This credit is effective beginning with tax year 2007. For the purposes of this fiscal note, it is assumed that the sales tax credit

provided in this bill would *reduce* revenue by **$81 million** annually, beginning with FY 2008. There is no impact from the credit in the 2007 biennium.

21. In addition, eliminating the 101 state mills and mill levies associated with the BASE portion of school funding for tax year 2006 (FY 2007), will act to increase individual income taxes in FY 2007. These changes to property taxes are estimated to increase state income tax liabilities for full-year residents by **$2.784** million in FY2007.

Oil and Gas Production Tax

22. Section 17 of this bill amends 15-36-331, MCA to eliminate any distribution of oil and natural gas production revenue to the 6-mill university system account for production after December 31, 2006. This will reduce revenue to the university system account by half the FY 2007 current law amount and by the entire FY 2008 current law amount, or by $868,000 in FY 2006, and by $1.735 million in FY 2008. Revenue to the state general fund will increase by $868,000 in FY 2007, and by $1.735 million in FY 2008.

Revenue Summary

23. The following tables show this bill's effects on revenue to the general fund and the university system 6 mill account.

General Fund	FY 2006	FY 2007
95 mills	($4,524,989)	($176,029,440)
95 mills non-levy revenue	-	($3,755,000)
occasionally occupied fee	-	$18,528,336
sales tax	-	$149,403,000
income tax	-	$2,78,4000
oil and gas tax	-	$868,000
Total	($4,524,989)	($8,201,104)

University System 6 mill account	FY 2006	FY 2007
6 mills	($285,789)	($11,117,649)
6 mill non-levy revenue	-	($300,000)
oil and gas tax	-	($868,000)
Total	($285,789)	($12,285,649)

Tax Administration

24. To implement the sales tax, the Department of Revenue would need a new sales tax module for its data processing system. The total cost would be $5,500,000, with half in FY 2006 and half in FY 2007. The department would need 78 additional FTE beginning in FY 2007. Associated costs would be $2,661,061 for personal services, $779,791 for operating expenses, and $538,200 for equipment.
25. To implement the new occasionally occupied residential property fee, the department would hire 12 employees for half of FY 2006. In FY 2007, the department would need 49 seasonal employees. Personal services costs would be $144,876 in FY 2006 and $785,692 in FY 2007. Operating expenses would be $116,430 in FY 2006 and $691,582 in FY 2007. Equipment costs would be $69,600 in FY 2006 and $214,600 in FY 2007.

Office of Public Instruction:

26. Present law (MCA 20-9-326) requires the Governor to include inflation adjustments for the entitlements in the recommendations presented to the legislature. These present law entitlements result in the following expenditures: direct state aid will be $329.36 million in FY 2006 and $332.62 million in FY 2007. Guaranteed tax base aid to schools will be $104.62 million in FY 2006 and $105.40 million in FY 2007. County retirement costs will be $21.52 million in FY 2006 and $22.23 million in FY 2007.
27. State special education payments will be $38.5 M in FY 2006 and $39.3 M in FY 2007. [current HB2 approp as of 3/25/05]
28. Oil and gas revenues budgeted in school district general funds for FY 2005 were $4.62 M. The amount budgeted was 36% of the estimated amount available. The amount collected in FY 2005 district general funds will be $12.83 M ($4.62 divided by 36%). Te amounts collected in FY 2006 and FY 2007 will be the same.
29. Section 81 of SB 517 repeals the district general fund BASE levy in FY 2007. Without a general fund BASE levy, no district will be eligible for guaranteed tax base subsidies (GTB) under 20-9-367. Therefore, it is assumed that direct state aid payments beginning in FY 2007 will fund 80% of the basic and per-student entitlements and 40% of the state special education payments after nonlevy revenues are considered at the district level. State payments will increase to replace district general fund BASE levies that currently support 40% of the special ed funding and 35.3% of the entitlements with GTB subsidies, less non-levy revenues:

				FY2007
State Payments under SB 517:				
80% of entitlements				$595.3 M
State special ed funding				$ 39.3 M
add'l 40% of state special education funding				$ 15.7 M
Less: District nonlevy revenues				
HB 124 Block Grants		$43.7 M		
HB 20/417 Property Tax reimbursements		$1.3 M		
Oil and Gas Revenues	$12.83 M			($ 57.83 M)
State funding for school general funds			(a)	$ 592.47 M
Less				
State Payments under current law:				
44.7% of entitlements ("direct state aid")				$332.6 M
State special ed funding				$ 39.3 M
GTB				$105.4 M
State funding for school general funds			(b)	$477.3 M
Increased state payments to schools			(a) - (b)	$115.17 M

30. Under current law, the state will receive federal forest payments of $2.205 million in FY 2007 as non-levy revenue. With the elimination of the state 95 mill education levies, 84% of this revenue will go to county-wide school retirement funds. The state pays guaranteed tax base aid (GTBA) to these funds, and GTBA payments will be reduced by 27% of the increase in federal forest payments. This will reduce general fund expenditures for GTBA by $0.502 million in FY 2007.

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference

FTE	6	109.77
Expenditures:		
Personal Services	$144,876	$3,446,753
Operating Expenses	$2,866,430	$4,221,373
Equipment	$69,600	$752,800
Transfers – School Funding	$0	$114,668,000
TOTAL	$3,080,906	$123,088,926
Funding of Expenditures:		
General Fund (01)	$3,080,906	$123,088,926
Revenues:		
General Fund (01)	($4,524,989)	($8,201,104)
State Special Revenue (02)	($285,789)	($12,285,649)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	($7,605,895)	($131,290,030)
State Special Revenue (02)	($285,789)	($12,285,649)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
Local governments and school districts will receive an additional $4.055 million ($3.755 million + $300,000) in non-levy revenues in FY 2007 and thereafter, from repealing the 95 mills levied for state general fund purposes and the university 6-mill levy.

Beginning with FY 2008, local governments would receive half of the revenue generated by the new occasionally occupied residential property use fee provided for in the bill. This is estimated to increase revenue to local governments by $9.264 million in FY 2008, and to increase each year with growth in the market value of properties subject to the fee.

Beginning in FY 2008, with an estimated growth rate of class 8 of 3.9% in tax year 2005 and 2.9% in subsequent years, the proposed class 8 exemption change to the first $50,000 of all class 8 owners would reduce taxable value by approximately $24.8 million.

a. The statewide average mill levy for this property in tax year 2004 (FY 2005) is 511.63. Statewide mill levies have increased annually by 4.5% since FY 2001. Assuming growth of 4.5%, the statewide average mill levy would be 583.85 (511.63 x 104.5% ^ 3 years) in FY 2008.
b. Removing the states 101.53 (95.53 + 6) mills, local governments and schools would have an estimated average statewide mill levy of 482.66 (583.85 – 101.53) in FY 2008.
c. The associated revenue decrease to local governments and school districts under the proposal is estimated to be $11.96 million ($24,800,000 x 482.32) in FY 2008.
d. Under 15-10-420, MCA, county and city governments could float their mill levies to offset this property tax revenue loss. Since the amount of loss associated with this bill is so significant, mill increases would be very large; this would shift the impacts onto other taxpayers, particularly homeowners.
e. Tax Increment Finance (TIF) districts w have their revenue reduced by about $2.211 million, annually. This could impact some TIF districts' ability to service their bonding obligations without other local government action.

Beginning with tax year 2006 local governments are authorized to implement a local option sales tax of up to 2%. This tax is tied to the state sales tax base. Revenue to local governments will depend on which local governments opt to implement the tax (on voter approval), and the tax rate provided for. Local property tax mill levies will be reduced by the number of mills that otherwise would be levied to support the BASE portion of school district general fund budgets under current law.

LONG-RANGE IMPACTS:

Revenue and Expenditures
FY 2008 is the first fiscal year when all of the provisions of this bill would in place. The following table shows the revenue and expenditure impacts of this bill in FY 2008. Both the revenue and expenditure impacts would grow over time.

SB 517 Impacts in FY 2008	
General Fund	
Expenditures	
Tax Administration	$5,670,926
School Funding	$114,668,000
Total	$120,338,926
Revenue	
Property Tax	($185,417,382)
Occasionally Occupied Property Fee	$9,264,168
Sales Tax	$314,851,000
Income Tax (Sales Tax Credit)	($78,216,000)
Oil and Gas Produciton Tax	$1,735,000
Total	$62,216,786
Net Effect on Fund Balance	($58,122,140)
University System 6 Mill Account	
Property Tax	($12,178,270)
Oil and Gas Production Tax	($1,735,000)
Total	($13,913,270)

Class 8 Business Equipment
Section 7 of the bill amends the class 8 property tax rate reduction trigger, rather than eliminating the tax rate as in current law, the proposal would increase the exemption amount for certain aggregate property amounts each year for 4-years until the first $500,000 in market value is exempt for all owners with $1 million or less in equipment. If the trigger were hit, actual implementation of the increased exemption amounts would not occur until the second year following the year in which the trigger is hit.

These changes are effective beginning with tax year 2007. November, 2007 is the earliest that the trigger could be hit, and tax year 2009 (FY 2010) is the earliest that implementation of increased exemption amounts could occur.

If the trigger is hit in tax year 2007, beginning in tax year 2009, taxpayers with an aggregate market value of class 8 property of less than $500,000 would be allowed to exclude from property taxation the first $100,000 in market value of all class 8 properties. Under this scenario, tax year 2009 taxable value is further reduced by approximately $12.00 million, for a total taxable value reduction of $36.8 million. If local government mill levies continue to grow at approximately 4.5% per year, local governments and schools would experience a potential loss in revenue of $20.3 million due to the exemption.

The trigger in each year under the proposal would continue to increase, allowing those with an aggregate of $750,000 or less an exemption of $250,000 for two years, then for all successive years allowing all aggregate owners of $1 million or less in class 8 property an exemption of $500,000. Assuming the aforementioned natural growth in value and mill levies, the new trigger has a total potential impact to local governments and schools of approximately $42 million in revenue. Under 15-10-420, MCA, county and city governments could float their mill levies to offset this property tax revenue loss. Since the amount of loss associated with this bill is so significant, mill increases would be very large; this would shift the impacts onto other taxpayers, particularly homeowners.

TECHNICAL NOTES:

1. Section 7(6)(a), amending 15-6-138, provides that the first $50,000 of class eight property is exempt for a person or business entity that owns an aggregate of $5,000 or less in market value of class eight property. This section should be amended to clarify that the intent is to increase the current law exemption from $5,000 to $50,000.
2. Section 7 provides different levels of exemption based on the aggregate value of class 8 property owned by the taxpayer. There may be constitutional concerns in providing different tax exemptions for the same class of property.
3. The current exemption for class 8 property (aggregate of $5,000) is not included in 15-6-201,MCA, which is a description of property that is exempt from property taxation. The class 8 exemption, along with the new contingent exemptions if the "class 8 trigger" is met should be added to this section of statute (15-6-201, MCA). Note that the current contingency for the "class 8 trigger" is included in this section of law, but the proposal strikes this reference.
4. Section 9 permits the Department of Revenue to treat separate entities as a single business for purposes of setting the class 8 exemption, but does not define what are functionally single businesses. This should be clarified.
5. Section 9(3) requires the Department of Revenue to create administrative rules to define a "single" business. Currently the department does not require all business taxpayers who do not have a registered FEIN to report an SSN, as it is considered confidential information.
6. Section 16 provides that "an individual" is allowed the sales tax credit against individual income tax. This term needs clarification. Does it pertain just to the taxpayer? The taxpayer's spouse? All individuals in the household?
7. Section 21 identifies who is responsible for the sales and use tax. The definition of "activity" exceeds the scope of permissible taxing authority as it presently exists. Language is needed to specify that this tax applies "to the extent not preempted by Federal law."

8. Section 29 indicates the premiums of an insurance company are exempt from the sales tax. It might be better to state the premiums "paid to" an insurance company are exempt, since it is the purchaser's premiums that are exempt and not the insurance companies' premiums.
9. Sections 49 through 51 provide for a local option sales tax subject to a vote of the local electorate. Section 50(1) indicates the maximum local option sales tax is 2% which would be based on the same goods and services authorized "by sections 49 through 51" which is the local option sales tax section. The correct reference should be sections 18 through 62, which references the state sales tax.
10. The local option sales tax provided for in Section 49 through 51 is intended to be tied to the general sales tax provided for in sections 18 - 62, however the effective date of the local option tax is one year earlier (tax year 2006).
11. Section 63 establishes a fee for occasionally occupied residential property. A fee imposed on non-residents is likely subject to constitutional challenge. The rationales provided in Section 63 for unequal treatment may not be sufficient to stand a challenge in court.
12. Section 64 imposes a fee on occasionally occupied residential property (OORP) equal to 0.5% of the market value of the residence and real property on which the residence is located. Except for tax year 2006, the fee is split among the county and the state. It is not clear what part of the "real property" the fee is based on. If it is meant to be coextensive with the definition of OORP, there is a problem establishing market value of agricultural and forest lands. The definition of OORP in subsection (5)(b) is not clear. With neither "and" or "or" between the 3 definitions, it is not clear whether property is OORP if it meets any one of the three requirements or if it must meet all three.
13. Section 65 provides an income tax credit for the fee imposed by section 64. There are no criteria as to who receives the tax credit, so apparently anyone who pays the fee receives the credit. Section 65 provides that taxpayers subject to the occasionally occupied residential property fee are allowed a nonrefundable credit against individual or corporation license taxes for the amount of the fee. The result is that there is a shifting of taxes to the county from the state in the amount of 50% of the fee. This section also provides that a taxpayer subject to the fee who also qualifies for the credit may, in lieu of paying the fee and receiving the credit receive an exemption from payment of the fee. How would this be administered? What determines when the taxpayer is exempt? Must the fee be fully absorbed by the credit before the taxpayer is exempt, or can the taxpayer be exempt if the fee is $1,000 and the tax liability against which the fee may be credited is just $10?
14. Section 64 Subsection (2)(a) provides for the payment to be made to the County Treasurer on returns provided by the Department. Section 64 Subsection (4) provides for the reporting and collection of the fee in conjunction with similar functions of the property tax. The subsection also states that the Department can adopt a rule to provide for the payment of the fee along with the property taxes on real property. This second part would indicate that the fee could be collected on the yearly property tax bill sent out from the Treasurers Office, but most of the subsequent sections of the Bill treat the administration of the Bill as if it is collected on a separate return sent out by the DOR.
15. Section 64 Subsection (5) defines market value as the meaning provided in 15-8-111 (2), but provides that the fee be collected on agricultural and forest land associated with the dwelling. However, agricultural land and forestland are valued at productive capacity, which is a different subsection of 15-8-111.
16. Sections 66 through 72 appears to copy existing sections of current law relating to administration of a variety of taxes. These sections are confusing and in some instances inappropriate relative to the administration of the occasionally occupied residential property fee.
17. Sections 82 and 83 refer to "the special revenue account established for the collection of sales tax and use tax in 15-68-820." Section 15-68-820 MCA requires all sales tax proceeds to be deposited in the general fund, and this bill does not amend that section.
18. It appears that sections 90, 91, and 92 of the original draft are in the bill by mistake.

19. Section 96, subsection (2) provides that sections 7 and 12 through 42 are effective January 1, 2007. If the intent is to make the statewide sales tax effective January 1, 2007 this should read "sections 7 and 18 through 48."
20. Under 20-5-324, MCA, the state pays tuition charges for a student who attends school outside the student's district of residence if the student is placed in a home or institution by a state agency or court. The state's obligation is currently withheld at the local level from the remittance of the 55 mill levy revenue. The state is still responsible for this payment, but it is likely that some counties will not have enough money in the county equalization accounts (20-9-331 and 333) to cover the cost of mandatory tuition for state-placed students as required in 20-5-324. [Section 56 of SB 512]
21. Elimination of the 55-mill county equalization levy will reduce the eligibility of school districts for federal Impact Aid.
22. With the elimination of the BASE budget levy, state guaranteed tax base aid for school district general fund budgets would also be eliminated. Sections of Title 20, Chapter 9 need to be amended to reflect the eliminations of GTB.
23. Section 59 amends the duties of the county treasurer and eliminates the requirement for the county treasurer to remit the county equalization monies to the state. Subsection (13) of 20-9-212 should not be stricken from the statute as the remaining monies in the county equalization account should still be remitted to the state in order for the state to make BASE aid payments.