GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2009 Biennium

Bill #	HB0816	**Title:**	Revise water's edge tax law
Primary Sponsor:	Erickson, Ron	**Status:**	As Introduced

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

FISCAL SUMMARY

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Expenditures:				
Revenue:				
General Fund	$0	$2,600,000	$2,600,000	$2,600,000
Net Impact-General Fund Balance	$0	$2,600,000	$2,600,000	$2,600,000

Description of fiscal impact:

This bill makes several changes to the apportionment of income for members of a group of related corporations that have elected to have income apportioned to Montana based on its United States income rather than its worldwide income. These changes are expected to increase corporation license tax revenue to the general fund by $2.6 million per year.

FISCAL ANALYSIS

Assumptions:

1. Montana requires corporations that have common ownership (for example, one owns another or both are owned by a common corporate parent) and are part of a common line of business to file a combined report. The income of members of such a "unitary group" is apportioned to Montana based on the combined income and apportionment factors of the group. This makes the income apportioned to Montana independent of financial arrangements between group members, such as the pricing of inter-company sales.
2. The normal corporation license tax rate is 6.75%. This rate is applied to the share of a corporation's worldwide income apportioned to Montana and its Montana source income. A corporation can elect to pay a higher rate of 7% and have only its United States income included in the apportionment process.

This is called a "water's-edge election." When a corporation that is part of a unitary group makes a water's-edge election, some of its foreign affiliates may be excluded from the apportionment process.

3. This bill makes several changes to the tests for whether a foreign affiliate is included in the apportionment process of a member of a unitary group that has made a water's-edge election. It allows a corporation to rescind an existing water's-edge election beginning with the first tax period that would be affected by this bill.
   a. Under current law, domestically incorporated affiliates are excluded from the combined reporting requirement if less than 20% of their payroll and property is in the United States. This bill eliminates this exclusion.
   b. Under current law, a subsidiary incorporated in another country must be included if more than 20% of its property and payroll is in the United States. For a foreign-owned corporation, this bill includes subsidiaries of the foreign parent corporation that meet the 20% property and payroll test.
   c. If a member of a water's edge affiliated group earns more than 20% of its income from selling services or intangibles to other members of the group, this bill would include the income and apportionment factors from those sales of services and intangibles.
   d. Under current law, any member of an affiliated group that is incorporated in a tax haven must be included in the combined report. This bill adds five countries to the list of tax havens.
   e. This bill would require that the United States income and apportionment factors of a member of a unitary group be included in the combined report if the tests for including its total income and apportionment factors are not met.
4. The Department of Revenue recalculated taxes for the largest companies with water's-edge elections for the last three tax years as if this bill had been in effect for those years. Tax liability with the provisions of this bill averaged $2.6 million per year higher than with current law.
5. The returns from the last three years did not provide information on the income and apportionment factors of some affiliates that would be included under this bill. Assuming that these corporations continued their water's-edge elections, the actual increase in revenue would be more than $2.6 million per year.
6. Corporations make the water's-edge election because it reduces their tax liability. Some corporations might find that their water's-edge tax liability under this bill is more than their regular tax liability, which is more than their water's-edge tax liability under current law. A corporation in this situation might rescind its water's-edge election. The increase in tax liability for such a corporation would be less than the amount found from recalculating its last three year's returns.
7. The impact on revenue from affiliates that were not included in recalculating returns is expected to be larger than the impact from some corporations possibly rescinding their water's-edge elections. The increase in revenue is therefore expected to be at least $2.6 million per year.
8. This bill applies to tax years beginning after December 31, 2006. The increase in revenue will first be seen in FY 2009 when corporations file their tax year 2007 returns.
9. This bill would not affect the Department of Revenue's costs of administering the corporation license tax.

	FY 2008 Difference	FY 2009 Difference	FY 2010 Difference	FY 2011 Difference
Fiscal Impact:				
Revenues:				
General Fund (01)	$0	$2,600,000	$2,600,000	$2,600,000
TOTAL Revenues	$0	$2,600,000	$2,600,000	$2,600,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$0	$2,600,000	$2,600,000	$2,600,000

Long-Range Impacts:

1. The revenue impact of this bill is likely to grow over time with growth in corporation license tax collections.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*