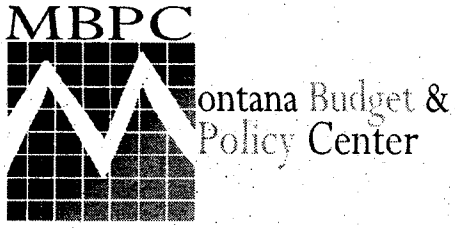
Menu of Revenue Options for a Balanced Approach to Montana's Economic Recovery



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Special Series: Balanced Solutions for 2011

All Montanans want a state we can be proud of--a state where our children can learn, grow, prosper, and stay to raise their own families. That future depends on our ability to invest in the public structures that educate our children, keep our communities safe, protect our land and water, and provide health care and other services when we struggle to make ends meet.

Like all other states, the Great Recession is threatening Montana's ability to adequately invest in these public structures. State revenues have fallen, and legislative staff is estimating that the next legislature may face over a $360 million revenue gap.

Montana deserves a balanced approach to this revenue crisis that looks not just at dramatic and harmful cuts to public services, but also targeted efforts to increase revenue. This brief is one in a series of MBPC reports that explores policies to responsibly raise revenue in the state.

Legislators are already considering options for closing the revenue shortfall in our next state budget. Unfortunately, most of the options being considered are cuts to the programs that educate our children, keep our families and communities healthy and safe, and help our most vulnerable neighbors make ends meet. These programs also create jobs for teachers, nurses, and other workers throughout the state. A cuts-only approach will result in laid off workers, cancelled contracts, students unprepared for a new economy and a further drag on our already struggling economy.

Legislative staff has released over 100 options for dealing with our budget challenges; the vast majority propose harmful cuts to state services, and only a few of them find new ways to raise revenue.[1] The Montana Budget and Policy Center offers the following menu of revenue options as potential mechanisms for meeting our revenue challenges with a more balanced approach. We offer the menu as a first step in demonstrating the diverse options that exist for maintaining funding for the public structures that make Montana a great place to live and work.

SENATE TAXATION
EXHIBIT NO. 2
DATE 1.14.11
BILL NO. NA

Improve Tax Compliance

Most Montana families and businesses lawfully pay the taxes they owe and contribute to our collective ability to fund the programs, services, and infrastructure that help make our communities strong, safe, and healthy. Unfortunately, not all taxpayers are paying the money they owe. The Department of Revenue has estimated that the state has more than a $300 million tax gap, meaning that $300 million of owed taxes are not being collected each year.[2] Montana can raise necessary revenue by further investing in the Department of Revenue and pursuing concrete policy proposals that ensure all taxpayers are paying what the owe.

Collecting New Revenue Through Improved Tax Compliance		
Description	**Approximate Savings 2013 Biennium**	**Background Information and Citations**
Increase Funding for Department of Revenue Compliance Efforts - Currently, for each dollar invested in compliance, the department returns $8.1 in collections.	Depends on amount invested.	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. Department of Revenue, "Compliance and Collections Fiscal Year End 2010 Report."
Withholding on Non-Resident Sales of Montana Real Estate - Provide for an income tax withholding mechanism for non-resident sales of Montana real estate greater than $250,000. The current non-compliance rate for non-residents is over 70%.	$3 million	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also, H.B 647, 61st Legislature (2009) and associated fiscal note and 2013 Biennium Executive Budget.
Tax Avoidance on Business Sales - Ask non-residents to pay the same tax as residents on business sales. Require nonresidents who sell an interest in a Montana business to report and pay taxes on the gain just as Montana residents do.	$5.6 million	See 2013 Biennium Executive Budget.

Collecting New Revenue Through Improved Tax Compliance

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Require Disclosure of Inconsistent Tax Returns - Require multi-state corporations to disclose inconsistencies between their Montana returns and returns in other states.	To be determined.	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also H.B. 651, 61st Legislature (2009) and associated fiscal note.
Create Requirements for Large Centrally Assessed Property Protests - Prohibit contingent fee appraisals and require large protests be accompanied by a professional appraisal.	$1 million	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also H.B. 651, 61st Legislature (2009) and associated fiscal note.
Temporary Tax Amnesty - Amnesty programs generally allow people to avoid criminal prosecution, civil penalties, and a portion of the interest that is due, in return for paying their delinquent taxes.	$10 million	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also Legislative Fiscal Division "Reference Book," Revenue and Transportation Section.

Collecting New Revenue Through Improved Tax Compliance

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Increase Statute of Limitations for Corporate Tax - Increase the length of time the Montana Department of Revenue has to audit corporate tax returns from three years to five years. The statute of limitations for individual income tax returns is already five years.	$5.8 million	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also H.B 651, 61st Legislature (2009), associated fiscal note, and 2013 Biennium Executive Budget.
Combat Use of Abusive Tax Shelters - Require disclosure of potentially abusive tax avoidance transactions, and provide penalties for failure to comply.	$2.5 million	Forthcoming, MBPC, "Improving Tax Collections," www.MontanaBudget.org. See also, H.B 651, 61st Legislature (2009) and associated fiscal note.

Close Tax Loopholes

Each year Montana loses millions of dollars in needed revenue in the form of tax credits, deductions, and exemptions through the tax code. These are also known as "tax expenditures," or money the state loses when it creates special exceptions in the tax code. Although some of these expenditures may be good policy, unlike state spending, tax expenditures are rarely reevaluated after they are passed. Below are some examples of ways to evaluate and/or close costly loopholes costing the state millions:

Collecting New Revenue by Closing Tax Loopholes		
Description	**Approximate Savings 2013 Biennium**	**Background Information and Citations**
Review Tax Expenditures - Tax expenditures are tax provisions that exempt certain persons, income, goods or services, or property from taxes that would otherwise be due. In effect, tax expenditures represent indirect spending that occurs through the tax code. Montana spends hundreds of millions of dollars each year on tax expenditures. Currently tax expenditures are not subject to review or balanced against other spending priorities after they are passed. Instituting periodic review would ensure that tax expenditures are fulfilling their original intent and utilizing state resources most effectively.	To be determined.	See, e.g., Citizens for Tax Justice, "How to Enact and Maintain Tax Reform." Center on Budget and Policy Priorities, "Promoting State Budget Accountability Through Tax Expenditure Reporting."
Decouple from Federal Domestic Production Deduction – Montana is losing millions of dollars to a corporate tax break that never even received a vote in the state legislature. The federal government created the "domestic production deduction," in 2004. Because Montana bases its tax code on the federal tax code, the tax break was carried over without any consideration by state lawmakers. The deduction includes all domestic production nationally, so corporations may get the deduction in Montana even if they do not engage in production here.	$12 million	MBPC, "Montana Can Bypass a Costly and Ineffective Tax Break for Corporations," www.MontanaBudget.org.

Collecting New Revenue by Closing Tax Loopholes

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Repeal Oil and Gas Tax Holiday - Repeal provision creating lower tax rate for newly drilled wells in Montana.	$22 million	MBPC, "Can Montana Afford an Oil and Gas Tax Holiday?" www.MontanaBudget.org.
Repeal Capital Gains Credit - Remove the capital gains credit created in 2003. Montana is one of only nine states with a state-level capital gains credit in addition to the federal credit.	$68 million	MBPC, "Capital Gains Tax Reform Will Strengthen Montana," www.MontanaBudget.org.
Repeal Net Operating Loss Carrybacks - Repeal a tax provision allowing businesses to file amended income tax returns for past years in which they were profitable, use current year business losses to offset those profits, and receive refunds of taxes paid in past years. During recessions, when tax payments by businesses tend to fall, refunding business taxes paid in prior years can make revenue shortfalls even larger.	$4.3 million	See Center on Budget and Policy Priorities, "Minority of States Still Granting Net Operating Loss "Carryback" Deductions Should Eliminate Them Now." Legislative Fiscal Division "Reference Book", Revenue and Transportation Section and 2013 Biennium Executive Budget.
Prevent "Insurance Stuffing"- Ban non-insurance companies with a subsidiary or affiliated insurance company from transferring the non-insurance income, assets or gains to the insurance company in an attempt to shield them from ordinary taxation.	$2 million	See, e.g., S.B. 211, 61st Legislature (2009) and associated fiscal note.

Collecting New Revenue by Closing Tax Loopholes

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Close Loopholes on Pharmaceutical and Other Companies - Ensure Montana is capturing all of the taxes on income derived from sales in the state by preventing tax shifting to overseas locations.	$5.3 million	See, Charles Johnson, "Schweitzer Seeks Legislation to 'Fairly' Tax Drug Firms," and 2013 Biennium Executive Budget.
Reforming Itemized Deductions - Itemized deductions can have a harmful effect on tax equity. Low-income families receive little benefit from the deductions. The biggest benefits go to upper income families. The tax policy think tank, ITEP, suggests five ways to reform Montana's itemized deductions to improve fairness and raise revenue.	Up to $32 million	Institute on Taxation and Economic Policy, "'Writing off' Tax Giveaways: How States Can Help Balance Their Budgets by Reforming or Repealing Itemized Deductions" (includes MT specific fact sheet).
Technical Fix to SB407 - When SB407 was passed in 2003, the law contained a technical flaw that unfairly allows trusts certain tax benefits that individuals do not receive.	$4 million	See 2013 Biennium Executive Budget.
Reduce Individual Income Tax Credits by 10% - Reduce the 19 state individual income tax credits by 10% - the percentage of the anticipated revenue shortfall.	$10.5 million	Legislative Fiscal Division, "Reference Book," Revenue and Transportation Section.
Improve Collections of Per Capita Livestock Fees - Improving compliance in paying per capita fees by livestock owners would decrease the need for general fund dollars by the Department of Livestock.	To be determined.	Legislative Fiscal Division "Reference Book," Economic Affairs Section.

Collecting New Revenue by Closing Tax Loopholes		
Description	**Approximate Savings 2013 Biennium**	**Background Information and Citations**
Reduce Corporate Tax Credits by 10% - Reduce the 16 state corporate tax credits by 10% - the percentage of the anticipated revenue shortfall.	$1.1 million	See Legislative Fiscal Division "Reference Book," Revenue and Transportation Section.
Eliminate Deduction for Federal Taxes Paid - Montana is one of just six states that still has a deduction for federal income taxes paid, a deduction that disproportionately benefits the highest income earners in the state.	$100 million	ITEP, Who Pays? A Distributional Analysis of the Tax Systems in All 50 States, (including a Montana-specific fact sheet); Montana Department of Revenue, Tax Expenditure Report (2008).

Targeted Tax Increases

Most states have both raised taxes and made spending cuts to address the impact of the recession on state revenues.[3] Many highly-regarded economists have found that raising taxes during a recession, especially on the wealthiest, does less economic harm than deep cuts to public programs, services, and infrastructure.[4] In recent years, Montana has actually reduced taxes on the wealthiest taxpayers, costing the state hundreds of millions of dollars in funding for education, health care, roads, parks, and other public structures that Montana communities, businesses, and families rely on. In fact, when looking at our entire tax system, Montana's low and middle-income families pay higher effective tax rates than Montanans making over $434,000 per year.[5] Below are options for targeted tax increases:

Collecting New Revenue Through Targeted Tax Increases

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Restore Income Tax Brackets - SB 407, passed in 2003, lowered the top rate for the personal income tax and collapsed the tax brackets. At the time, proponents argued that these changes would spur economic growth in Montana. However, there is no evidence that SB 407 created additional growth in Montana's economy, and the changes have cost the state hundreds of millions of dollars in state revenue.	$370 million	MBPC, "Income Tax Bracket Collapse is Costing Montana," www.MontanaBudget.org.
Add New Top Income Tax Bracket and Rate - raise the top marginal rate for taxpayers with taxable income over $250,000 to 7.9%.	$45 million (using example provided)	See, e.g., H.B. 395, 61st Legislature (2009) and associated fiscal note.
Temporary Corporate and/or Individual Surcharge - In previous recessions, the Montana Legislature has imposed temporary surcharges on certain taxes. Other states (e.g. Connecticut and North Carolina) have implemented similar policies during this recession.	$33 million (for each 1% surcharge)	See Legislative Fiscal Division, "Reference Book," Revenue and Transportation Section.

Collecting New Revenue Through Targeted Tax Increases

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Establish Corporate Minimum Tax of $250 - Of the 14,353 corporations in Montana, 8,363 pay only the $50 minimum tax.	$3.3 million	Department of Revenue, Biennial Report, revised January 13, 2009.
Establish $250 Minimum Tax on S-Corps and LLC's - Montana, like nineteen other states, imposes only nominal taxes on businesses organized as subchapter S Corporations (S-Corps) or Limited Liability Companies (LLCs) even though these entities receive benefits from state services, education, and infrastructure.	$34 million	Center on Budget and Policy Priorities Report, "Reforming the Tax Treatment of S-Corporations and Limited Liability Companies Can Help States Finance Public Services."
Restore Inheritance Tax - Montana could join 21 other states that levy an estate or inheritance tax.	Unknown	Center on Budget and Policy Priorities, "State Taxes on Inherited Wealth Remain Common."
Soft Drink Excise Tax- Implement an excise tax on sugared beverages (revenue estimated based on tax at 2 cents per ounce).	$141 million	Rudd Center for Food Policy and Obesity, "Revenue Calculator for Soft Drinks" and "Taxes on soft drinks and snacks: State legislation filed as of April 2009." See also, Center on Budget and Policy Center, "Taxing Higher-Sugar Soft Drinks Could Help Pay for Health Care Reform;" SB 332, 59th Legislature (2005) and associated fiscal note.

Collecting New Revenue Through Targeted Tax Increases

Description	Approximate Savings 2013 Biennium	Background Information and Citations
Increase Cigarette Tax - In addition to increased state revenue, the Campaign for Tobacco Free Kids anticipates health-related benefits from a tax increase on cigarettes.	$37.2 million (for $1/ pack increase.)	Campaign for Tobacco-Free Kids, "Tobacco Taxes: A Win-Win for Cash Strapped States."
Tax Medical Marijuana - In 2004, Montanans passed an initiative to legalize medical marijuana. Montana could join other states and localities that have created a franchise fee or tax on proceeds from the sales of medical marijuana.	To be determined.	See Sen. Dave Lewis proposed bill LC 0100, 62nd Legislature (2011). See also, e.g., "Colorado Medical Marijuana Sales Tax Nets State 2.2 Million This Year," Huffington Post, Dec. 6, 2010; "Oakland, California Passes Landmark Marijuana Tax," CNN, July 22, 2009.

Other Options

The list below represents options that don't fall in to the compliance, closing loopholes, or targeted tax increase categories.

Other Options to Free Up Revenue		
Description	**Approximate Savings 2013 Biennium**	**Background Information**
Transfer Excess State Special Revenue Fund Balances to the General Fund - Fund balances that accumulate in certain special revenue funds beyond the amount needed to operate the relevant programs could be transferred to the general fund on a one-time-only basis.	$112 million (with a corresponding loss in state special revenue funds)	Legislative Fiscal Division "Reference Book," Multiple Committee Assignment Section.
Clarify Types of Pipeline Property included in Class 9 - Enact legislation reversing a state Supreme Court decision, *Omimex Canada*, that re-classified certain pipelines into Class 8, thus reducing state and local property tax revenue.	$11.9 million	See, e.g., H.B. 642, 61st Legislature (2009) and associated fiscal note.
Revert Some Unspent General Fund Appropriations from HB645 - HB 645 appropriated $259 million in general fund for the 2011 biennium. According to LFD, as of June 7, 2010 approximately 41.4% or $55.5 million of the appropriation has been expended. Outstanding appropriations could revert prior to the end of FY11, increasing the general fund balance by the same amount.	$5 million	Legislative Fiscal Division "Reference Book," Multiple Committee Assignment Section.

Other Options to Free Up Revenue		
Description	**Approximate Savings 2013 Biennium**	**Background Information**
Implement Provider Fees to Pay a Portion of Medicaid State Share - Montana already levies a bed day utilization fee on nursing homes and hospitals and uses the funds as a state match to draw down federal Medicaid funds. The legislature could expand the use of these fees to maintain or increase Medicaid.	To be determined.	Legislative Fiscal Division "Reference Book," Children, Families, Health and Human Services Section.

Conclusion

Montana policymakers have tough choices in front of them. There are no easy solutions for spurring economic growth or closing the revenue shortfall caused by the Great Recession. Montana needs a balanced approach to these challenges--an approach that includes revenue to maintain support for education, health care, infrastructure, and other public services that both protect our families and prepare us for a more prosperous future. The Montana Budget and Policy Center offers the above revenue options as examples of strategies that can move Montana beyond a short-sighted, cuts-only approach.

MBPC will be updating this menu periodically preceding and during the 2011 legislative session. Please sign up for updates at www.MontanaBudget.org.

Endnotes

1. "Reference Book," Legislative Fiscal Division, updated October 27, 2010, http://leg.mt.gov/css/fiscal/hot-topics.asp.
2. "Biennial Report: July 1, 2006 to June 30, 2008," Montana Department of Revenue, January 13, 2009.
3. Nicholas Johnson, Catherine Collins, and Ashali Singham, "State Tax Change in Response to the Recession," Center on Budget and Policy Priorities, March 8, 2010, at http://www.cbpp.org/cms/index.cfm?fa=view&id=3108.
4. See, e.g., "Montana Economists Join Hundreds Across the Nation in Urging States to Maintain Public Services," Montana Budget and Policy Center, April 21, 2009, http://www.montanabudget.org/sites/default/files/reports/Economist%20letter%20press%20release.pdf.
5. "Who Pays? A Distributional Analysis of the Tax Systems in all 50 States," Institute on Taxation and Economic Policy, November 2009.