Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Bill #	HB0532	**Title:**	Revise income tax using a flat tax rate and a tie to federal taxable income
Primary Sponsor:	Hollandsworth, Roy	**Status:**	As Introduced-Revised

- ☐ 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 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Expenditures:				
General Fund	$75,000	($1,082,897)	($1,340,816)	($1,354,691)
State Special Revenue	($2,000)	($1,000)	$0	$0
Revenue:				
General Fund	$245,000	$37,664,000	$30,668,000	$29,259,000
State Special Revenue	($2,000)	($1,000)	$0	$0
Net Impact-General Fund Balance:	$170,000	$38,746,897	$32,008,816	$30,613,691

Description of fiscal impact: This bill would replace the existing income tax rate schedule with a flat 5.5% rate, make the tax base the same as federal taxable income with a few adjustments, and eliminate most individual income tax credits. It also would eliminate the contractors' gross receipts tax and the offsetting credits.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. Beginning with TY 2014, this bill would replace the existing income tax rate schedule with a flat 5.5% rate. The base for the Montana income tax would be federal taxable income with a few adjustments. The income tax forecasting model was modified to reflect these changes. The following table shows the difference between calendar year tax liability from the modified model and model output under current law.

Year	Difference in Tax Liability ($ million)
2014	$5.624
2015	$4.757
2016	$2.028
2017	($0.794)

2. SJ2 allocates calendar year income tax liability equally between two fiscal years. HB 532 would take effect at the start of CY 2014, which is the middle of FY 2014. Thus, tax liability would be reduced for only half of FY 2014. The department would develop new income tax withholding schedules and provide them to employers in the fall of CY 2013. However, based on experience with previous rate changes, some employers are expected to take several months to begin using the new withholding schedules. These employers will over-withhold income tax during the second half of FY 2014, and their employees will have the over-withheld tax refunded in FY 2015 when they file their TY 2014 tax returns. Because of this, it is assumed that one-third of the revenue reduction expected for FY 2014 will actually occur in FY 2015. The left-hand column of the following table shows the calendar year differences in tax liability in assumption 1 allocated evenly between fiscal years. The right-hand column shows revenue changes with part of the change that should occur in FY 2014 shifted to FY 2015 because of the slow adoption of withholding tables.

Change in Revenue ($ million)

Fiscal Year	If Withholding Tables Adopted Immediately	With Likely Slow Adoption
FY 2014	$2.812	$1.875
FY 2015	$5.190	$6.127
FY 2016	$3.392	$3.392
FY 2017	$0.617	$0.617

3. This bill would eliminate most credits against the individual income tax. It also would eliminate the credits against both income tax and corporation license tax for contractors' gross receipts tax paid. The following table shows the credits this bill would eliminate and the amount of each reduced revenue in the latest tax year for which all returns have been filed.

Revenue Impact of Eliminated Credits and Deductions - Last Year of Actual Returns

Credit	Individual Income Tax 2011	Corporate License Tax 2010
Empowerment Zone Credit	$475	n/a
Alternative Fuel Conversion Credit	$26,822	n/a
Dependent Care Assistance Credit	$26,039	n/a
Research Credit	$149,633	n/a
Historic Building Preservation Credit	$105,214	n/a
Temporary Emergency Lodging Credit	$863	n/a
Film Employment Credit	$5,316	n/a
Film Expenditure Credit	$20,067	n/a
Energy Conservation Credit	$5,588,577	n/a
Geothermal Heating System Credit	$318,928	n/a

Alternative Energy Production Credit	$7,290	n/a
Mineral Exploration Credit	$0	n/a
Recycling Credit	$538,163	n/a
Oilseed Crushing/Biodiesel Facility Credit	$8,536	n/a
Biodiesel Blending Credit	$46,755	n/a
Adoption Credit	$274,849	n/a
Elderly Care Credit	$77,468	n/a
Health Insurance for Uninsured Montanans Credit	$192,670	n/a
Dependent Care Assistance Credit	$26,039	n/a
Contractor's Gross Receipts Tax Credit	$4,426,212	$906,127
Total	**$11,839,916**	**$906,127**
Elderly Homeowner/Renter Credit	$10,790,925	

4. The revenue impact of eliminating credits and deductions would first show up when taxpayers file their TY 2014 returns in FY 2015. In SJ 2, the elderly homeowner/renter credit is forecast explicitly and all other income tax credits are forecast as a group. Corporate tax credits are not explicitly forecast. The following table shows the revenue impacts of eliminating credits and deductions assuming that the income tax credits would grow at the rate forecast in SJ 2 and that the revenue impact of eliminating the corporate credit would be proportional to the SJ 2 corporation license tax forecast. Corporation license tax revenue is assumed to be the same in FY 2016 and FY 2017 as in FY 2015. The following table shows the revenue impact of eliminating credits. The difference in numbers between the table above and the table below is the assumed change in growth between FY 2011 or FY 2010 (above) for income tax and corporation license tax, respectively, and FY 2015 (below) for the same taxes.

Revenue Impact of Eliminated Credits ($ million)

	FY 2014	FY 2015	FY 2016	FY 2017
Elderly Homeowner/Renter Credit	$0.000	$10.786	$10.786	$10.786
Other Individual Income Tax Credits	$0.000	$17.378	$18.650	$20.016
Corporation License Tax	$0.000	$1.093	$1.099	$1.099

5. This bill would eliminate the public contractors' gross receipts tax beginning in 2014. This would eliminate half of projected revenue for FY 2014 and all of projected revenue for later years. The following table shows the revenue impact, assuming that revenue in FY 2016 and FY 2017 would be the same as is forecast for FY 2015.

Revenue Impact of Eliminating Contractors' Gross Receipts Tax ($ million)

FY 2014	FY 2015	FY 2016	FY 2017
($1.630)	($3.259)	($3.259)	($3.259)

6. Under current law, individual taxpayers are required to make a number of adjustments to federal adjusted gross income. Some of these require taxpayers to carry adjustments made in one year forward to a future year. HB 532 requires taxpayers to use any carried-forward adjustments in filing their 2014 tax returns. In most cases, some taxpayers will have positive adjustments, others will have negative adjustments, and the two will approximately cancel. One adjustment that will increase taxable income for many taxpayers with no offsetting decreases is refunds of federal income tax that was used as part of the taxpayer's itemized deduction for federal taxes in a previous year. Adjustments on 2011 income tax returns were used to estimate adjustments that would be carried forward and used in 2014. The net of additions and subtractions

is estimated to be $100.699 million. This additional taxable income would be subject to the new 5.5% rate which would increase revenue by $5.538 million.

7. The following table shows the revenue impact of each component of HB 532 and the total revenue impact

Net Change in General Fund Revenue
($ million)

	FY 2014	FY 2015	FY 2016	FY 2017
Income Tax Restructuring	$1.875	$6.127	$3.392	$0.617
Elimination of Income Tax Credits	$0.000	$28.164	$29.436	$30.802
Income Tax Transition Provisions	$0.000	$5.538	$0.000	$0.000
Elimination of Corporate Credit	$0.000	$1.093	$1.099	$1.099
Eliminate Contractors' Gross Receipts Tax	($1.630)	($3.259)	($3.259)	($3.259)
Total	**$0.245**	**$37.664**	**$30.668**	**$29.259**

DOR Administrative Expenses

8. This bill would take effect at the beginning of CY 2014. Elimination of the contractors' gross receipts tax and several tax credits will reduce the need to audit returns and answer taxpayer inquiries. Using federal taxable income as the starting point for the income tax return will make the return shorter and is expected to reduce the number of errors on returns that the department has to correct by about half. The department expects to be able to eliminate 2.00 FTE auditing positions in the middle of 2014, which is the beginning of FY 2015. Another 2.00 FTE auditing positions would be eliminated when processing of TY 2013 tax returns is finished at the end of CY 2014. Another 3.00 FTE positions would be eliminated at the beginning of FY 2016. Personal services costs would be reduced by $183,246 in FY 2015, $328,164 in FY 2016, and $334,420 in FY 2017. Operating cost savings would be $5,888 in FY 2015, $10,458 in FY 2016, and $10,612 in FY 2017.
9. With a shorter form, data entry and other processing of income tax returns would be reduced by 60%. The department would be able to eliminate 5.00 FTE and hire fewer temporary workers on contract during the processing season. Personal services costs would be reduced by $161,348 in FY 2015, $164,354 in FY 2016, and $167,416 in FY 2017. Operating expenses, including contract temporaries, would be reduced by $109,280 in FY 2015, $109,390 in FY 2016, and $109,500 in FY 2017.
10. Changes to the department's data capture and data processing systems to accommodate changed income tax returns would be made in FY 2014 at a cost of $75,000. Beginning in FY 2015, the annual workload for maintaining and updating the income tax modules of the department's data capture and data processing systems would be reduced by 20%. This would allow the department to eliminate 1.00 FTE and reduce purchases of contracted services from the system vendors by $500,000. Personal services costs would be reduced by $51,876 in FY 2015, $52,870 in FY 2016, and $53,882 in FY 2017. Operating expenses, including contracted services, would be reduced by $501,472 in FY 2015, $501,494 in FY 2016, and $501,516 in FY 2017.
11. With fewer credits and a simpler income tax form, the department will have fewer disputes with taxpayers and will be able to eliminate 1.00 FTE lawyer at the beginning of FY 2016. Personal service costs would be reduced by $83,651 in FY 2016 and $85,280 in FY 2017. Operating costs would be reduced by $1,494 in FY 2016 and $1,516 in FY 2017.
12. Income tax booklets would have fewer pages, and the department would produce only one version of the form and instructions instead of the existing Form 2, Form 2M, and Form 2EZ. Printing and mailing costs would be reduced by $7,500 per year beginning in FY 2015.
13. With a simpler form and fewer credits, less staff time would be required for the annual form revision process and there would be fewer questions from taxpayers during the filing season. The department would eliminate 0.50 FTE from forms design and 1.00 FTE from the call center in FY 2015 and an additional 0.50

FTE from the call center in FY 2016. Personal services costs would be reduced by $62,415 in FY 2015, $81,547 in FY 2016, and $83,133 in FY 2017. Operating costs would be reduced by $7,372 in FY 2015, $7,394 in FY 2016, and $7,416 in FY 2017.

Department of Commerce (DOC)

14. The bill amends the Big Sky on the Big Screen Act which is codified in Title 15, Chapter 31; MCA. The Big Sky on the Big Screen Act is Montana's primary incentive to drive film production to the State of Montana. The Act has been administered by the Department of Commerce Film Office and the Department of Revenue since its passage in 2005.
15. The current Big Sky on the Big Screen Act sunsets January 1, 2015.
16. There have been 109 productions certified under the Act. There have been 20 feature films, 46 national television ads, 16 nationally broadcast television programs, and 27 additional projects such as documentaries certified and filmed in Montana since passage. The economic impact of these certified projects was approximately $17.7 million and the total film industry impact was approximately $56.6 million.
17. Only 16% of the certified productions from 2010 through 2012 are C-corporations; therefore, 84% of certified productions would not film in Montana.
18. Based on $17.7 million of direct economic impact in the 7.5 years since the Act's passage, the change of this act would lead to a decrease in film production at the minimum of $1.98 million dollars per year ($1.98 million = $17.7 million / 7.5 * 84%). This in turn would lead to a proportional decrease in tax revenue generated by the new dollars brought into the state by these productions.
19. There is a fee of $500 due from any production company claiming the credit. This fee is appropriated in equal shares to the Department of Commerce and the Department of Revenue to offset the administrative costs of the Act. If the Act is repealed this revenue would be eliminated. For the purposes of this bill it is assumed that eight productions will file for the credit in FY 2014. For the purposes of this bill it is assumed that half the productions companies would apply for the credit in FY 2015 as they do in FY 2014.

Public Employees Retirement System (PERS)

20. HB 532 repeals 15-30-2110, MCA, so that the $3,600 pension benefit that is currently exempt from taxation is also repealed. This increases the tax liability of retirees of the retirement systems.

Fiscal Impact:	**FY 2014 Difference**	**FY 2015 Difference**	**FY 2016 Difference**	**FY 2017 Difference**
Department of Revenue (DOR)				
FTE	0.00	(11.50)	(16.00)	(16.00)
Expenditures (DOR):				
Personal Services	$0	($458,885)	($710,586)	($724,131)
Operating Expenses	$75,000	($624,012)	($630,230)	($630,560)
TOTAL Expenditures	$75,000	($1,082,897)	($1,340,816)	($1,354,691)
Funding of Expenditures (DOR):				
General Fund (01)	$75,000	($1,082,897)	($1,340,816)	($1,354,691)
TOTAL Funding of Exp.	$75,000	($1,082,897)	($1,340,816)	($1,354,691)
Department of Commerce (DOC)				
Expenditures (DOC):				
Operating Expenses	($2,000)	($1,000)	$0	$0
TOTAL Expenditures	($2,000)	($1,000)	$0	$0
Funding of Expenditures:				
General Fund (01)	$0	$0	$0	$0
State Special Revenue (02)	($2,000)	($1,000)	$0	$0
TOTAL Funding of Exp.	($2,000)	($1,000)	$0	$0
Revenues:				
General Fund (DOR)	$245,000	$37,664,000	$30,668,000	$29,259,000
State Special Revenue (DOC	($2,000)	($1,000)	$0	$0
TOTAL Revenues	$243,000	$37,663,000	$30,668,000	$29,259,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$170,000	$38,746,897	$32,008,816	$30,613,691
State Special Revenue (02)	$0	$0	$0	$0

Technical Notes:

Department of Revenue

1. Section 11(15) defines joint return to mean "a single return made jointly." Since the term "single return" is commonly used to refer to the return of a single taxpayer, it would avoid some potential confusion to make the definition "one return made jointly."
2. Section 14 changes the multiplier used in determining tax on a non-resident from "the ratio of Montana source income to total income from all sources" to "the ratio of Montana source income to federal taxable income." Since federal taxable income is income less deductions and exemptions, this change would increase the multiplier for most taxpayers and would make it more than 100% for some. This would leave the state open to attempting to tax income that is attributable to other states. Retaining the current language would avoid this problem. If the goal is to ease compliance and administration by tying to an item on the federal return, it would be safer to use federal adjusted gross income as the denominator in the ratio.

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