GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2015 Biennium

Bill #	HB0581		**Title:**	Revise income tax using a tie to federal taxable income and repealing credits
Primary Sponsor:	Hansen, Kris		**Status:**	As Amended in House Committee

- ☐ 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	$81,000	($757,320)	($965,076)	($976,475)
Revenue:				
General Fund	($12,051,000)	($16,786,000)	($18,366,000)	($21,255,000)
Net Impact-General Fund Balance:	($12,132,000)	($16,028,680)	($17,400,924)	($20,278,525)

Description of fiscal impact: Beginning in 2014, HB 581 (as amended) would revise the structure of the individual income tax, eliminate many credits against individual income tax and corporation license tax, and eliminate the public contractors' gross receipts tax. With simpler income tax forms, the Department of Revenue would ultimately be able to reduce costs by $1.0 million per year. The net effect is to reduce income tax collections, with the reduction growing over time.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. Beginning in CY 2014, HB 581 (as amended) would revise the structure of the individual income tax, eliminate many credits against individual income tax and corporation license tax, and eliminate the public contractors' gross receipts tax.
2. HB 581 would make federal taxable income, with a short list of adjustments, the base for the individual income tax. It would make taxable income subject to three rates, 1%, 3% and 6%, with separate rate tables for taxpayers who file a joint return, who file as head of household, and who file as single or married separately. HB 581 also eliminates preferential taxation of capital gains income.

3. The income tax forecasting model was modified to reflect the provisions of HB 581. The following table shows the differences between calendar year tax liability from the modified model and model output under current law.

Change in Calendar Year Tax Liability

year	$ million
2014	($31.263)
2015	($32.282)
2016	($35.385)
2017	($39.588)

4. SJ 2 allocates calendar year income tax liability equally between two fiscal years. HB 581 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 this 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 #3 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	($15.632)	($10.421)
FY 2015	($31.772)	($36.983)
FY 2016	($33.833)	($33.833)
FY 2017	($37.487)	($37.487)

5. HB 581 would eliminate many of the credits that are allowed against individual income tax and corporate license tax. It also would eliminate the additional deduction for the purchase of recycled material. The following table shows provisions that would be eliminated and the amount that each reduced revenue in the latest year for which all returns have been filed.

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

	Individual Income Tax 2011	Corporate License Tax 2010
College Contribution Credit	$246,667	$5,605
Alternative Fuel Conversion Credit	$27,322	$14,000
Health Insurance for Uninsured Montanans Credit	$196,790	$31,753
New or Expanded Industry Credit	n/a	$0
Elderly Care Credit	$77,468	$0
Recycling Credit	$583,873	$47,884
Recycling Deduction	*	$4,974,408
Oilseed Crushing and Biodiesel Credit	$8,537	$0
Biodiesel Blending and Storage Credit	$46,755	$0
Contractors' Gross Receipts Credit	$5,332,339	$906,127

Geothermal Heating System Credit	$327,275	$0
Alternative Energy Production Credit	$7,290	$100
Dependent Care Assistance Credit	$26,278	$0
Historic Property Preservation Credit	$134,763	$0
Infrastructure Users Fee Credit	$31,612	$501,904
Empowerment Zone Credit	$475	$0
Research Credit	$155,843	$372,491
Mineral Exploration Credit	$0	$25
Film Employment Credit	$0	$0
Film Expenditure Credit	$22,456	$11,110
Adoption Credit	$297,831	n/a
Film Employment Refundable Credit	$5,316	n/a
Temporary Emergency Lodging Credit	$1,013	$0
Total	**$7,529,903**	**$6,865,407**

An "n/a" in the table indicates that the credit is not allowed for that tax under current law. An asterisk indicates that the tax impact of eliminating the deduction is calculated in the income tax model.

6. The revenue impact of eliminating credits and deductions would first show up when taxpayers file their 2014 returns in FY 2015. In SJ2, the individual income tax credits eliminated by this bill are forecast as a group. Corporate license tax credits are not explicitly forecast. The following table shows the revenue impacts of eliminating credits and deductions. It assumes that the income tax credits would grow at the rates forecast in SJ2 through 2015 and at the average of the rates for the previous three years in 2016. It assumes that the impact of corporate credits and deductions would be constant.

Revenue Impact of Eliminated Credits and Deductions ($ million)

	FY 2014	FY 2015	FY 2016	FY 2017
Individual Income Tax	$0.000	$11.052	$11.861	$12.626
Corporation License Tax	$0.000	$6.865	$6.865	$6.865

7. HB 581 would eliminate the public contractors' gross receipts tax beginning in CY 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 the SJ 2 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)

8. 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 581 requires taxpayers to use any carried-forward adjustments in filing their CY 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 TY 2011 income tax returns were used to estimate adjustments that would be carried forward and used in TY 2014. The net of additions and subtractions is estimated to be $100.699 million. The average marginal tax rate for taxpayers with

adjustments in CY 2014 would be 5.5%. The net effect of adjustments carried forward and used in TY 2014 would be to increase revenue by $5.538 million.

9. The following table shows the revenue impact of each component of HB 581 and the total revenue impact.

Net Change in General Fund Revenue

	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**
Income Tax Restructuring	($10.421)	($36.983)	($33.833)	($37.487)
Elimination of Income Tax Credits	$0.000	$11.052	$11.861	$12.626
Income Tax Transition Provisions	$0.000	$5.538	$0.000	$0.000
Elimination of Corporate Credits and Deductions	$0.000	$6.865	$6.865	$6.865
Eliminate Contractors' Gross Receipts Tax	($1.630)	($3.259)	($3.259)	($3.259)
Total	**($12.051)**	**($16.786)**	**($18.366)**	**($21.255)**

10. 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 3.00 FYE auditing positions during FY 2015. Another 2.00 FTE positions would be eliminated at the beginning of FY 2016. Personal services costs would be reduced by $136,983 in FY 2015, $233,877 in FY 2016, and $238,335 in FY 2017. Operating cost savings would be $4,416 in FY 2015, $7,470 in FY 2016, and $7,580 in FY 2017.
11. With a shorter form and fewer credits, data entry and other processing of income tax returns would be reduced. The department would be able to eliminate 4.00 FTE and hire fewer temporary workers on contract during the processing season. Personal services costs would be reduced by $129,078 in FY 2015, $131,483 in FY 2016, and $133,933 in FY 2017. Operating expenses, including contract temporaries, would be reduced by $107,808 in FY 2015, $107,896 in FY 2016, and $107,984 in FY 2017.
12. 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 $81,000. 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 10%. This would allow the department to eliminate 1.00 FTE position and reduce purchase of contracted services from the system vendors by $250,000. 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 $251,472 in FY 2015, $251,494 in FY 2016, and $251,516 in FY 2017.
13. 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.
14. 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 $5,900 per year beginning in FY 2015.
15. 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 a 0.50 FTE position from forms design and 1.00 FTE position from the call center in FY 2015 and an additional 0.50 FTE position 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)

16. Section 40 of the bill repeals the tax credits that are available to borrowers in the Infrastructure Loan Program (17-6-316, MCA) in the Board of Investments (BOI), please see technical note below. There is no fiscal impact to the BOI.
17. The bill repeals the Big Sky on the Big Screen Act which is codified in Title 15, Chapter 31, MCA, which has been administered by the Department of Commerce film office and the Department of Revenue since its passage in 2005. The current Big Sky on the Big Screen Act sunsets January 1, 2015.
18. Only 16% of the certified productions from 2010 through 2012 were C-corporations; therefore, 84% of certified productions would lose the tax credit.
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. 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.

Department of Environmental Quality (DEQ)

20. This bill (as amended) requires DEQ to advise the Department of Revenue on energy conservation measures that would qualify for tax credits, and energy systems using a recognized non-fossil form of energy generation or a low emission wood or biomass combination device. This work will be absorbed within existing resources.
21. DEQ will rely on the EPA certification to determine what will qualify for wood stove tax credits, and on the EPA process to qualify hydronic heaters and will not develop its own certification process.

Fiscal Impact:	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Department of Revenue				
FTE	0.00	(9.50)	(13.00)	(13.00)
Expenditures:				
Personal Services	$0	($380,352)	($583,428)	($594,563)
Operating Expenses	$81,000	($376,968)	($381,648)	($381,912)
TOTAL Expenditures	$81,000	($757,320)	($965,076)	($976,475)
Funding of Expenditures:				
General Fund (01)	$81,000	($757,320)	($965,076)	($976,475)
TOTAL Funding of Exp.	$81,000	($757,320)	($965,076)	($976,475)
Revenues:				
General Fund (01)	($12,051,000)	($16,786,000)	($18,366,000)	($21,255,000)
TOTAL Revenues	($12,051,000)	($16,786,000)	($18,366,000)	($21,255,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($12,132,000)	($16,028,680)	($17,400,924)	($20,278,525)

<u>Technical Notes:</u>

Department of Commerce (BOI)

1. The bill repeals the tax credits that are available to borrowers in the Infrastructure Loan Program (17-6-316, MCA) operated by the Board of Investments (BOI). If the Infrastructure Loan Program tax credits are repealed, infrastructure loans become regular commercial loans, with additional restrictions; i.e. the business must be basic sector and the loan is sized by the number of new jobs created.

Department of Public Health and Human Services (DPHHS)

2. The DPHHS is anticipating using Modified Adjusted Gross Income (MAGI) when determining client eligibility electronically. If the bill is passed in its present form, the proposed definition of income (in Section 56) will conflict with MAGI.

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