# Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

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| **Bill #** | HB0592 | **Title:** | Provide military income tax exemptions |
| **Primary Sponsor:** | Mehlhoff, Robert (Bob) | **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 2014 Difference | FY 2015 Difference | FY 2016 Difference | FY 2017 Difference |
|---|---|---|---|---|
| **Expenditures:** | | | | |
| General Fund | $0 | $0 | $0 | $0 |
| **Revenue:** | | | | |
| General Fund | ($927,850) | ($946,407) | ($966,820) | ($987,232) |
| **Net Impact-General Fund Balance:** | ($927,850) | ($946,407) | ($966,820) | ($987,232) |

**Description of fiscal impact:** HB 592 exempts the first $5,000 of salary received by a resident of Montana in the Montana National Guard or as a reservist in the armed forces from state income tax. The reduction to the general fund is estimated to be nearly a million dollars per year.

## FISCAL ANALYSIS

**Assumptions:**

**Department of Revenue**

1. Under current law, military salaries received by members of the regular armed forces and by members of the National Guard and Reserve who are on active duty are not subject to state income taxes. Guard and reserve members' earnings when not on active duty are not exempt. HB 592 would exempt the first $5,000 of salary received by a resident of Montana for military service in the Montana National Guard or as a reservist in the armed forces from state income tax.
2. By November 1 of each year, the Department of Revenue (DOR) will multiply the salary amount ($5,000 for the first year) by an inflation factor for that tax year and round the salary amount to the nearest $10. The inflation factor is the CY 2012 consumer price index.
3. In Section 1 of the bill, subsection (4) appears to conflict with subsections (3)(a). This fiscal note assumes that the cost of the bill is due to (3)(a) which exempts the first $5,000 of salary.
4. The DOR does not have information indicating which taxpayers are in the National Guard or in Reserve units or what their incomes are or other tax-related data, such as numbers of dependents. DOR was able to

obtain information on National Guard members, but was not able to obtain information on reservists for this fiscal note. Therefore this fiscal note may be understated.

5. Total salaries paid to Montana National Guard that would be affected by this bill was $37.7 million in federal fiscal year (FFY) 2012 (Department of Military Affairs). The total number of persons affected is 3,374 and average pay was $11,170.
6. Most members of the guard and reserves have other jobs or businesses and these earnings would continue to be subject to income tax. The average taxable income for full-year residents in CY 2011 in Montana was $26,699. If these taxpayers are assumed to have the same taxable income as all full-year residents, then their total earnings would be equal to $26,699 plus $11,170, or $37,869 per year on average. Based upon the analysis by decile group of taxable income and average tax liability (see page 66, *2010-2012 Biennial Report*), the average marginal tax rate for taxpayers in this income range in TY 2011 was about 5.5%.
7. Exempting $5,000 of income from taxation at this average marginal tax rate would reduce taxes by about $275 if the exemption had been in place for TY 2011.
8. HB 592 directs the department to increase the exemption amount by an inflation factor, in this case the 2012 consumer price index. Using the consumer price index (all-urban, 1982-1984) provided in the IHS forecast used to create the official forecast for this session, the average CPI (all-urban) for the four quarters of 2011 was 2.249397 and the same number for all four quarters of 2012 was 2.295796, yielding a change in the index for 2012 of 2.06%.
9. Applying the 2.06% growth rate to $5,000 yields $5,103. Rounded to the nearest $10, this exemption is $5,100.
10. Applying the 2.06% growth rate to $5,100 yields $5,205. Rounded to the nearest $10, this exemption is $5,210.
11. Applying the 2.06% growth rate to $5,210 yields $5,315. Rounded to the nearest $10, this exemption is $5,320.
12. Applying the 2.06% growth rate to $5,320 yields $5,430. Rounded to the nearest $10, this exemption is $5,430.
13. It is not entirely clear from the bill what exemption is to be used in the first tax year. This fiscal note assumes that for the first tax year, TY 2013, the exemption is $5,000. Therefore the decrease to general fund revenue would be $927,850 (3,374 times $275). Taxpayers will file their TY 2013 returns in the spring of 2014 (FY 2014) and claim larger refunds or have reduced taxes owed.
14. For the second tax year, TY 2014, the exemption is $5,100. Applying the average marginal tax rate of 5.5% yields a decrease of $281. Therefore, the decrease to general fund revenue would be $946,407 (3,374 times $281). Taxpayers will file their TY 2014 returns in the spring of 2015 (FY 2015) and claim larger refunds or have reduced taxes owed.
15. For the third tax year, TY 2015, the exemption is $5,210. Applying the average marginal tax rate of 5.5% yields a decrease of $287. Therefore, the decrease to general fund revenue would be $966,820 (3,374 times $287). Taxpayers will file their TY 2015 returns in the spring of 2016 (FY 2016) and claim larger refunds or have fewer taxes owed.
16. For the fourth tax year, TY 2016, the exemption is $5,320. Applying the average marginal tax rate of 5.5% yields a decrease of $293. Therefore, the decrease to general fund revenue would be $987,232 (3,374 times $293). Taxpayers will file their TY 2016 returns in the spring of 2017 (FY 2017).
17. The exemption applies to tax years beginning after December 31, 2012.
18. No additional costs to DOR are assumed to be incurred due to provisions of this bill.

| **Fiscal Impact:** | **FY 2014 Difference** | **FY 2015 Difference** | **FY 2016 Difference** | **FY 2017 Difference** |
|---|---|---|---|---|
| **Department of Revenue** | | | | |
| **Expenditures:** | | | | |
| **TOTAL Expenditures** | $0 | $0 | $0 | $0 |
| | | | | |
| **Funding of Expenditures:** | | | | |
| General Fund (01) | $0 | $0 | $0 | $0 |
| **TOTAL Funding of Exp.** | $0 | $0 | $0 | $0 |
| | | | | |
| **Revenues:** | | | | |
| General Fund (01) | ($927,850) | ($946,407) | ($966,820) | ($987,232) |
| **TOTAL Revenues** | ($927,850) | ($946,407) | ($966,820) | ($987,232) |
| | | | | |
| **Net Impact to Fund Balance (Revenue minus Funding of Expenditures):** | | | | |
| General Fund (01) | ($927,850) | ($946,407) | ($966,820) | ($987,232) |

**Technical Notes:**

1. As noted in assumption #3, there is a conflict between two sections. One section exempts the first $5,000 of income received from non-active duty work by these taxpayers. A later section appears to exempt all salary received by a Montana resident for this work.
2. The application of the inflation factor is not entirely clear in the proposed language (see assumption #8)

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