Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Bill #	SB0208	**Title:**	Revise tax laws related to water's edge elections
Primary Sponsor:	Barrett, Dick	**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	$2,000,000	$4,000,000	$6,000,000	$8,000,000
Net Impact-General Fund Balance:	$2,000,000	$4,000,000	$6,000,000	$8,000,000

Description of fiscal impact: This bill proposes to eliminate the water's election for corporate license taxpayers. This change to corporate license taxes is estimated to increase general fund revenues by $8 million per year, phased in over several years, as current elections expire. Implementing provisions of the bill will require system changes. These changes can be made as part of the annual forms change process.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. Under current state law, corporations doing business in the state and that have Montana source income are subject to the corporate license tax. In the case of corporations with many member companies, corporations, or subsidiaries, state law typically requires those that have common ownership to file a combined report. The purpose of combined reporting is to make the apportionment of income to Montana independent of the financial arrangements between group members. Where all the income earned by the corporation or the combined group is due to Montana sources, the entire income earned is Montana taxable income. In the case of multi-jurisdictional (multi-state or multi-national) corporations, income of the members of the group of corporations under common ownership is apportioned to Montana based upon the combined apportionment factors of the group. Sales, property, and payroll are the three factors used to

apportion taxable income to Montana. These factors are equally weighted to produce the overall apportionment factor which is applied to total taxable income to produce Montana taxable income.

2. While Montana is generally a worldwide combined filing state as described above, under current state law corporations can elect to file in Montana as a water's edge corporation. Under a water's edge election, the corporation pays a higher rate, 7% versus the regular rate of 6.75%, on its Montana taxable income. However, only its domestic, rather than worldwide income and apportionment factors are included in the apportionment process. There are some exceptions in current law. For example, income from certain jurisdictions considered tax havens in state law must be included in the calculations.
3. A corporation can elect to file a water's edge election for a three year period and cannot change the election within that period without consent of the Department of Revenue. Of approximately 16,000 C corporations filing Montana corporate license tax returns, 358 had valid water's edge election for tax year 2012.
4. This bill proposes to repeal the water's edge election, but allows any existing water's edge election to remain in effect until it expires.
5. Over the past several years, the department has estimated revenue increases due to narrowing the water's edge provisions; the resulting estimates ranged from almost $2.0 million to $2.6 million per year. However, based upon audit experience, eliminating the water's edge election - in effect requiring reporting income and apportionment factors on a worldwide combined basis – are estimated to result in a net revenue increase of $8 million per year in general fund revenue by the end of the phase out of the water's edge elections.
6. This bill is effective on passage and approval, however any water's edge election made before the effective date continues until its normal expiration date. No new water's edge elections can be made by corporations after the effective date of this section.
7. Because the water's edge election lasts three years, the increase in revenue is assumed to phase in evenly over several fiscal years. Therefore the revenue increase is assumed to be $2 million in FY 2014, $4 million in FY 2015, $6 million in FY 2016, and $8 million in FY 2017 and all years thereafter.
8. The changes proposed in the bill require some system changes and associated testing. It is anticipated the changes could be part of the annual forms change process.

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)	$2,000,000	$4,000,000	$6,000,000	$8,000,000
TOTAL Revenues	$2,000,000	$4,000,000	$6,000,000	$8,000,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$2,000,000	$4,000,000	$6,000,000	$8,000,000

Technical Notes:

1. The amendment found in Section 3 (15-31-324(2)) is ambiguous. Currently, the department requires that taxpayers submit a water's edge election within the first 90 days of the first tax year of the 3-year period. Thus, a calendar year taxpayer would, under current rules, need to submit an election by the end of March or before. The amended language of subsection (2) (an election made before the effective date...), however, could be construed to permit an election made after that 90-day period. This ambiguity could make this difficult to administer and confusing for taxpayers.

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