# Fiscal Note 2017 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

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|---|---|---|---|
| **Bill #** | HB0595 | **Title:** | Provide tax credit for higher education expenses |
| **Primary Sponsor:** | Fitzpatrick, Steve | **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 2016 Difference | FY 2017 Difference | FY 2018 Difference | FY 2019 Difference |
|---|---|---|---|---|
| **Expenditures:** | | | | |
| General Fund | $41,606 | $38,627 | $39,154 | $39,690 |
| **Revenue:** | | | | |
| General Fund | ($26,079,000) | ($27,053,000) | ($28,027,000) | ($29,001,000) |
| **Net Impact-General Fund Balance:** | ($26,120,606) | ($27,091,627) | ($28,066,154) | ($29,040,690) |

**Description of fiscal impact:** HB 595 will reduce general fund revenue by $26 million in the first year, increasing by almost a million dollars each year as the unused carryforward credits are claimed in subsequent years. The Department of Revenue will need to add 0.50 FTE in order to administer the new educational credit.

## FISCAL ANALYSIS

**Assumptions:**

1. Beginning with tax year (TY) 2015, HB 595 provides for a tax credit of up to $1,000 for qualified higher education expenses paid by the taxpayer for themselves, their spouse or their dependents. Higher education expenses include amounts paid for tuition, fees and other related expenses required to enroll or attend a college, university, vocational school or other postsecondary educational institution eligible to participate in a student aid program run the U.S. Department of Education. The educational institution does not have to be in Montana. The tax credit is not refundable so the amount of the credit that is claimed in that tax year cannot exceed the taxpayer's tax liability in that tax year. However, any amount of the credit not used up can be carried forward for up to 15 years.
2. Data provided by the Commissioner of Higher Education indicates that there are 34,410 resident students in the Montana University system and about 5,208 resident students at other institutions that would qualify for this credit. Based upon information available on national databases, the Commissioner of Higher Education estimates the number of Montanans attending out-of-state institutions is equal to approximately 15% of the

in-state resident enrollment. Therefore, there are about 45,560 students whose expenses could qualify for this credit.

3. For purposes of this fiscal note, it is assumed that each student, or their parents or spouse, is incurring annual qualified educational expenses equal to or greater than the maximum amount of the credit ($1,000).
4. However, because the credit is not refundable, the maximum amount of the credit will not be claimed by all taxpayers in the first year because their state tax liabilities are less than the credit. These taxpayers can carry forward the unused credit and use it in future years to reduce tax liability if they have a state tax liability. For purposes of this fiscal note, it is assumed that the taxpayers incurring qualified educational costs (students, parents or spouses) have a taxable income and tax liability distribution similar to the entire population of taxpayers.
5. The table below shows the average tax liability by decile group (one-tenth of the total group) for 2013, the most recent year available from state tax return data (see pp. 62-63 of the most recent *Biennial Report*, DOR). The table also shows the estimated number of taxpayers who could claim the credit by decile group (one-tenth of 45,560) and the amount of credits potentially claimed by the taxpayers. So in the first year of the credit the maximum that would be claimed is about $26 million, assuming all taxpayers who could claim the credit against their tax liability did so in that first year.

| Year 1 | | | |
|---|---|---|---|
| Decile Group by Income | Average tax liability | Number in decile group | Credits claimed by decile group |
| 1 | - | 4,556 | $0 |
| 2 | $20 | 4,556 | $91,121 |
| 3 | $97 | 4,556 | $441,939 |
| 4 | $243 | 4,556 | $1,107,125 |
| 5 | $499 | 4,556 | $2,273,479 |
| 6 | $865 | 4,556 | $3,941,001 |
| 7 | $1,276 | 4,556 | $4,556,070 |
| 8 | $1,833 | 4,556 | $4,556,070 |
| 9 | $2,771 | 4,556 | $4,556,070 |
| 10 | $8,890 | 4,556 | $4,556,070 |
| Total | | | $26,078,945 |

6. This leaves $19.482 million of unused credits available to claim in future years against tax liability in the first year. However, a share of students and/or their spouses or parents move out of state each year. Overall about 15% of the U.S. population moves every year, with about 2.3% of the moves to another state within the U.S. The same census data also indicates that individuals in their late 20s tend to be the most likely to move. A survey of Montana University System students in 2002 and 2003 found that about 70% remain in the state. Also as shown in the table above, the average tax liability does not exceed $1,000 until the seventh decile group which in 2013 corresponded to Montana adjusted gross income of between $35,264 and $44,678. Therefore, not all carryover credits will be usable in the next year. So the unused credits will be claimed over a number of years and some will not be claimed at all.
7. For purposes of this fiscal note, it is assumed that 75%, or $14.611 million, of the remaining unused credits will be claimed sometime over the 15 years available to claim them.
8. The credits are assumed to be claimed evenly over the next 15 years, or $974,000 per year. The net result of these assumptions is that almost 90% of the credits for each year will be claimed, over time (($26,078,945 + $14,611,000) / $45,560,000).

9. In year 2, the total number of credits claimed is estimated to be $27.053 million ($26.079 million in new credits plus $0.974 million carried over from year 1).
10. In year 3 the total number of credits claimed is estimated to be $28.027 million ($26.079 million plus $0.974 million carried over from year 1 and from year 2).
11. In year 4 the total number of credits claimed is estimated to be $29.001 million ($27.897 million plus $0.974 million carried over from each of years 1, 2, and 3).
12. The credits claimed on the tax year 2015 returns will reduce general fund revenue in FY 2016. The credits claimed on tax year 2016 returns will reduce general fund revenue in FY 2017. The tax year 2017 credits will reduce general fund revenue in FY 2018 and the tax year 2018 credits will reduce general fund revenue in FY 2019.
13. The Department of Revenue (DOR) will need to make changes to forms and instructions in order to implement this bill as well as make changes to the tax processing and data management system. The changes will be made in the normal annual process for review and revisions.
14. The credit carryforward will need to be tracked. DOR will need to add 0.50 FTE in order to implement the provisions of this bill and will incur additional costs of $41,606 in FY 2016, $38,627 in FY 2017, $39,154 in FY 2018 and $39,690 in FY 2019.
15. The bill is effective on passage and approval and applies retroactively to tax years beginning after December 31, 2014 (TY 2015).

| | FY 2016 Difference | FY 2017 Difference | FY 2018 Difference | FY 2019 Difference |
|---|---|---|---|---|
| **Fiscal Impact:** | | | | |
| **FTE** | 0.50 | 0.50 | 0.50 | 0.50 |
| **Expenditures:** | | | | |
| Personal Services | $31,923 | $31,923 | $32,349 | $32,783 |
| Operating Expenses | $6,385 | $6,704 | $6,805 | $6,907 |
| Equipment | $3,298 | $0 | $0 | $0 |
| **TOTAL Expenditures** | $41,606 | $38,627 | $39,154 | $39,690 |
| **Funding of Expenditures:** | | | | |
| General Fund (01) | $41,606 | $38,627 | $39,154 | $39,690 |
| **TOTAL Funding of Exp.** | $41,606 | $38,627 | $39,154 | $39,690 |
| **Revenues:** | | | | |
| General Fund (01) | ($26,079,000) | ($27,053,000) | ($28,027,000) | ($29,001,000) |
| **TOTAL Revenues** | ($26,079,000) | ($27,053,000) | ($28,027,000) | ($29,001,000) |
| **Net Impact to Fund Balance (Revenue minus Funding of Expenditures):** | | | | |
| General Fund (01) | ($26,120,606) | ($27,091,627) | ($28,066,154) | ($29,040,690) |

**Long-Term Impacts:**

1. The amount of credits claimed is expected to increase over time.

**Technical Notes:**

1. The bill states that if this credit is claimed, the amount of any other related deduction or credit allowed under the same chapter (which is based upon the same expenditures) must be reduced by the dollar amount of this credit. There are no current deductions or credits at the state level likely to reduce the amount of the credit. There are federal credits and tuition and fee deductions that are available and this fiscal note assumes those have no impact on use of the proposed state credit.

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