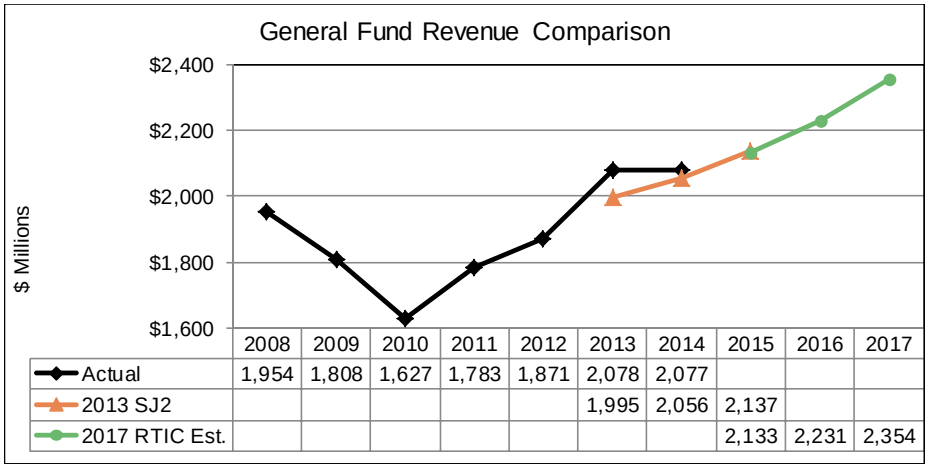
STATE REVENUE

General Fund Revenue Estimates as Adopted by RTIC

On November 20, 2014, Revenue and Transportation Interim Committee (RTIC) met to review and adopt a revenue estimate recommendation. The executive recommendation was $295.4 million above the LFD recommendation. The committee ultimately adopted the LFD recommendations, with total adjustments in individual income tax and oil and natural gas tax equal to half of the total difference between the executive and LFD recommendations for individual income tax, corporation income tax, and oil and natural gas tax.



The table below shows the annual detail for the top seven general fund revenue sources and subtotal of remaining sources.

General Fund Revenue Estimates as Adopted by RTIC
($ Millions)

Source of Revenue	Actual FY 2014	Estimated FY 2015	Estimated FY 2016	Estimated FY 2017	Estimated 2015 Bien	Estimated 2017 Bien
Individual Income Tax	$1,063.3	$1,108.3	$1,212.5	$1,295.8	$2,171.6	$2,508.3
Property Tax	250.3	249.8	245.4	255.3	500.2	500.7
Corporation Income Tax	147.5	157.7	148.6	152.5	305.2	301.1
Vehicle Taxes & Fees	101.1	102.3	103.6	104.8	203.4	208.3
Oil & Natural Gas Production Tax	109.6	95.2	90.6	92.7	204.8	183.3
Insurance Tax & License Fees	60.9	63.9	65.4	66.1	124.8	131.5
Video Gambling Tax	57.1	60.4	62.7	66.0	117.6	128.8
Largest Seven Subtotal	1,789.9	1,837.7	1,928.8	2,033.3	3,627.6	3,962.1
Remaining Sources Subtotal	287.2	295.3	301.9	320.2	582.4	622.2
Total General Fund	$2,077.0	$2,133.0	$2,230.7	$2,353.5	$4,210.1	$4,584.2

Executive Estimate

The difference between the executive and LFD revenue estimate were almost entirely explained by the differences in three revenue sources. As summarized in the table below, difference in the individual and corporation income taxes and oil & natural gas production taxes accounted for 95.5% of the overall difference between the two total estimates.

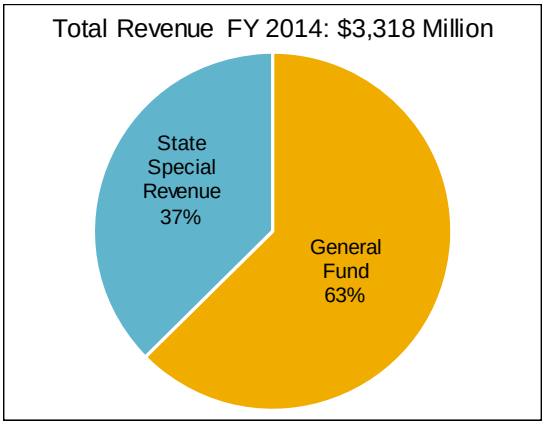
Key Differences from Executive Revenue Estimate ($ Millions)				
	Executive 3-Year Total	LFD 3-Year Total	3-Year Difference	% Share of Total Difference
Individual Income Tax	$3,602.8	$3,486.8	$115.9	39.2%
Corporation Tax	572.7	458.8	113.9	38.5%
Oil & Natural Gas Production Tax	319.9	267.3	52.5	17.8%
U.S. Mineral Royalties	95.3	76.2	19.2	6.5%
Remaining	2,281.0	2,287.1	(6.1)	-2.1%
Total General Fund	$6,871.6	$6,576.2	$295.4	100.0%

Legislative Options

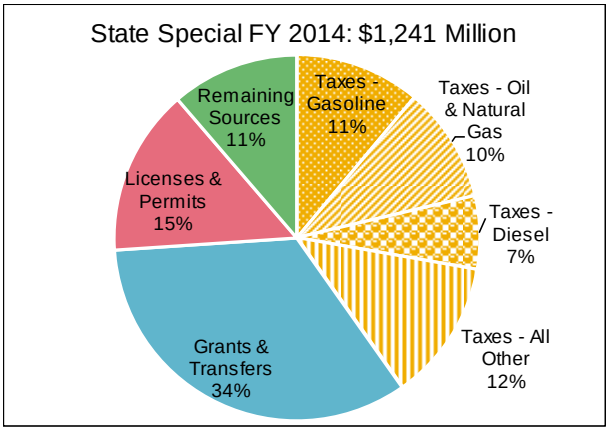
While the RTIC established initial revenue estimates for session, the committee recognized the need to continue evaluating the revenue estimates. During session, as more information becomes available, the LFD will make updates available to the legislature. In addition, throughout the session, the House and Senate Tax committees and the House and Senate committees of the whole will have opportunities to revise the revenue estimates contained in HJ 2.

General Fund & Other State Revenue Sources

Most general taxes are deposited in the state general fund. The general fund is used for most broad purposes of state government; education, health, and corrections are the predominant uses of this fund. State special fund revenues are raised and used for specific purposes. For example the state levies a gas tax that is dedicated for use on state roads and highways. Details of all general fund and most major state special fund revenue sources are contained in the Legislative Fiscal Division's 2017 Biennium Budget Analysis: Volume 2.

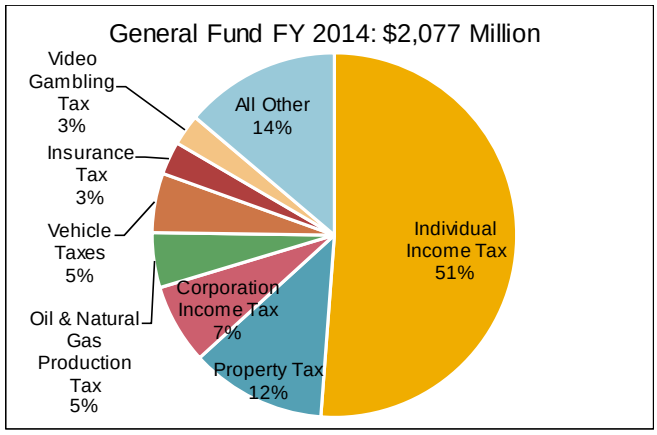


Most of the focus during session tends to be on the state general fund which accounted for 63% of FY 2014 total state revenue. Note that trusts or direct services funds such as unemployment insurance and workers' compensation insurance are not included in the adjacent chart. In addition, there is limited double counting as some sources of revenues are transferred between funds.

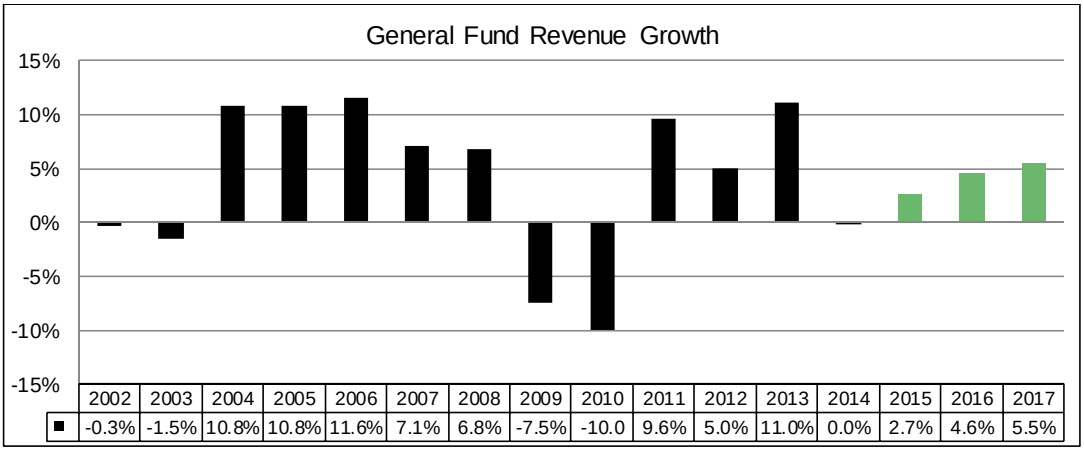


Large sources of state special revenue include the gasoline and diesel taxes, and oil and natural gas production tax. In FY 2014, the various taxes accounted for 40% of total state special revenue. Grants and transfers were the next largest contributor, amounting to 34% of state special revenue.

The largest seven sources of general revenue are individual income tax, property tax, corporation income tax, oil and natural gas taxes, vehicle taxes, insurance tax, and video gambling tax. In FY 2014, these sources accounted for 86% of total general fund revenue.



The chart below shows the annual percent change in revenue, with actual values shown in black and estimated values shown in green. The estimate for annual growth in general fund revenue for FY 2015 is 2.7%, for FY 2016 is 4.6% and for FY 2017 is 5.5%. These growth rates are slightly lower than the growth rates contained in the 2017 Outlook Revenue Detail, primarily due to the lower IHS estimates of oil price and short-term interest rates, and lower property tax reappraisal values.

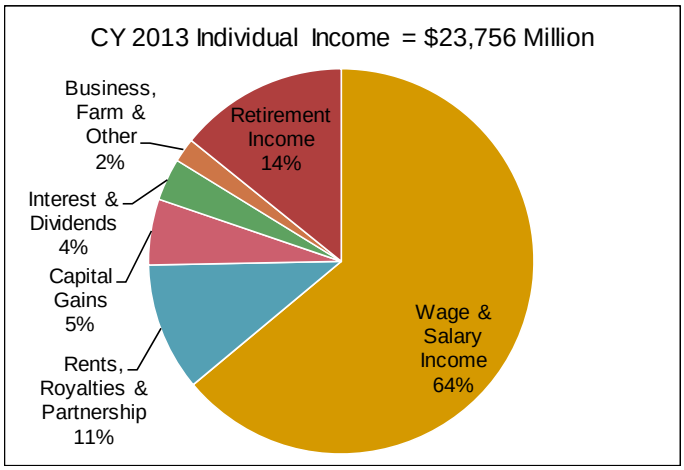


	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
■	-0.3%	-1.5%	10.8%	10.8%	11.6%	7.1%	6.8%	-7.5%	-10.0	9.6%	5.0%	11.0%	0.0%	2.7%	4.6%	5.5%

Five of the top seven tax sources, the significant economic drivers and their influence on the general fund are highlighted in the following sections. More details on all sources of revenue can be found in the Legislative Fiscal Division's 2017 Biennium Budget Analysis: Volume 2.

Individual Income Tax

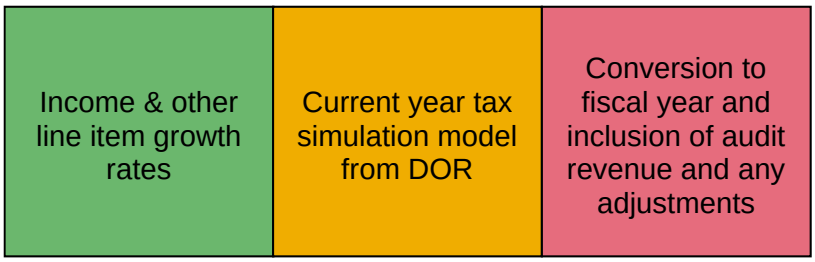
The individual income tax is levied against taxable income, which is defined as total Montana income adjusted for exemptions and deductions. In 2013, full year resident income totaled $23.8 billion. Once tax liability is determined, the amount of tax due is computed by subtracting allowable credits. Tax rates vary from 1.0% to 6.9%, depending on the level of taxable income. Tax brackets, personal exemption amounts, and the standard deduction are adjusted by the rate of inflation in each year. The tax rate on capital gains income is less than the tax rate on ordinary income by 2%. Wage income accounts for nearly two-thirds of total individual income, while withholding tax on wages accounts for about one-third of total general fund revenue.



The individual income tax estimating process contains three broad steps, which are illustrated in the diagram below. First, growth rates for each income type and other line items are developed—income streams are generally modeled on various IHS predictors, while many of the smaller addition, reduction or deduction items are forecast based on historical trend or an assumption of no growth.

Second, a tax simulation model produces a calendar year state tax liability forecast by applying the modeled growth rates to each resident taxpayer's income and deduction items. The model is updated each year by the Department of Revenue (DOR) to incorporate the changes in federal and state tax law. The LFD estimate utilized the CY 2013 tax simulation model and CY 2013 taxpayer data provided by DOR as the basis for forecasted state tax liability.

Finally, fiscal year collections before audit, penalty, and interest income are modeled on total calendar year liability, and forecast fiscal year collections are then augmented by expected future audit, penalty and interest collections to produce the total individual income tax revenue estimate.

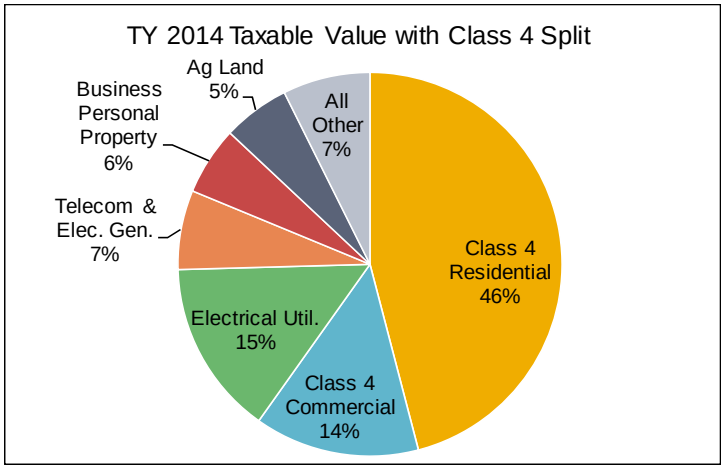


Executive Estimate

The executive estimate relied on the CY 2012 tax simulation model and CY 2013 taxpayer data. Each year DOR updates the tax simulation model to reflect changes in state and federal tax laws, and individualize it to a given tax year's taxpayer data. Using current taxpayer data with a prior year's model may lead to an incomplete assessment of state tax liability.

Property Tax

Montana law requires counties to levy a county equalization levy of 55 mills, a state equalization levy of 40 mills, and 6 mills for the university system against all taxable value in each county. A mill levy of 1.5 mills is also applied against all property in the five counties with a vocational technology (vo-tech) college. Taxable value is defined as the market value of statutorily defined property times a statutory tax rate.

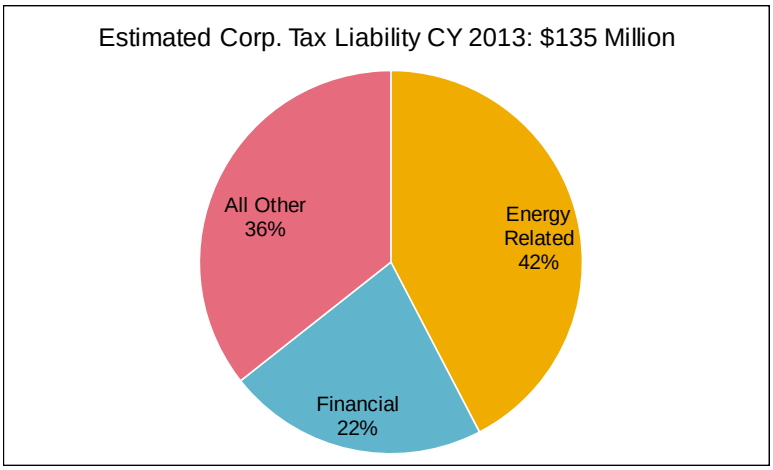


Agricultural land, timber land, and residential and commercial land values are reappraised every six years; all other property classes are reappraised annually. The 2014 reappraisal will be the basis for FY 2016 property tax. Further detail on whether the reappraisal may cause a budget pressure is highlighted in the Risks & Pressures section.

Corporation Income Tax

The corporation income tax is levied against a corporation's net income earned in or attributable to Montana, adjusted for allowable credits. The tax rate is 6.75%, except for corporations making a "water's edge" election (see 15-31-322, MCA), who pay a 7.0% tax on their net income.

Financial and energy related sectors are the largest contributors to corporation income tax liability. Primary economic drivers of this source include oil prices, median house price, and retail sales.



Since several of the sector models rely on the IHS forecast of West Texas Intermediate (WTI) oil price, the IHS November downward revision has a significant impact on the LFD estimate of corporation income tax—resulting in a revenue reduction of about $25 million over the three-year period.

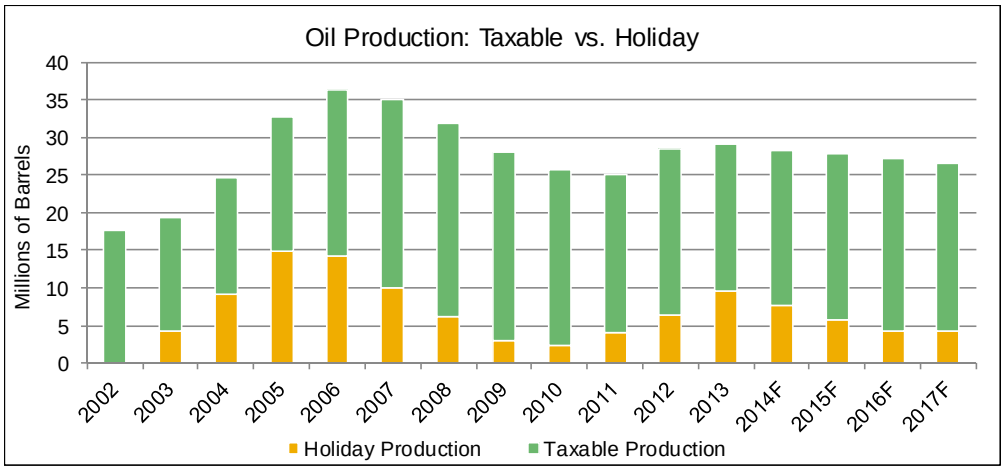
Executive Estimate

The executive forecast is based on a model using lagged U.S. corporate profits, while the legislative forecast takes a multi-sector approach using multiple economic variables to forecast various corporate sectors. The difference between the two approaches has been discussed extensively throughout the interim; for more information, see the report here: Corporation Tax Estimating: Using Confidence Intervals to Minimize Forecasting Error.

Oil & Natural Gas Production Tax

The oil and natural gas production tax is imposed on the production of petroleum and natural gas in the state. The gross taxable value of oil and natural gas production is based on the type of well and type of production, and whether the production occurs within the tax holiday.

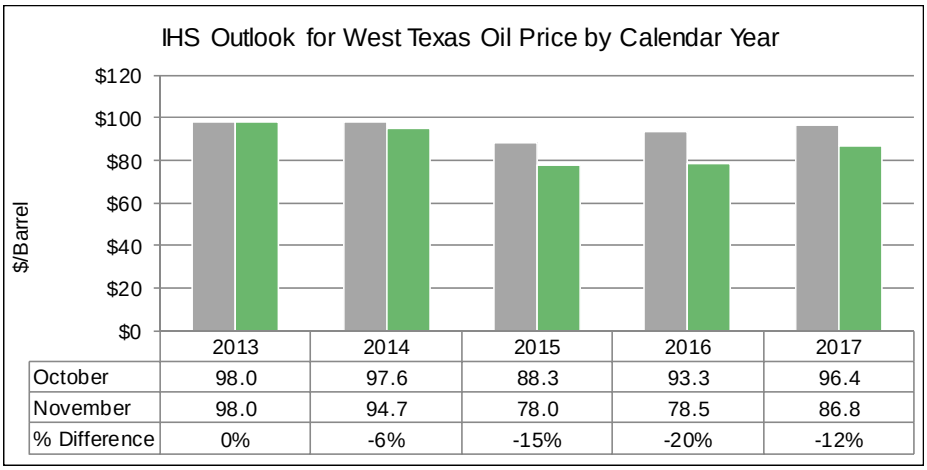
Oil production peaked in Montana in 2006 and fell 34% by 2011. Exploratory drilling in 2012 and 2013 resulted in an increase in production; the estimate assumes a gradual decline as the surge in exploratory drilling has tapered off.



At the national level, lower oil prices tend to correspond with a better economic outlook; manufacturing and transportation costs are lower, and consumers have more income to spend on goods and services. The impact on Montana revenue is more nuanced, however—although overall consumer activity may increase with lower prices, natural resource extraction and related industry activity may decline, resulting in lower individual, corporation and natural resource tax collections. Montana oil price tracks closely with West Texas Intermediate oil price, with an approximate 10% reduction to account for transportation costs.

Executive Estimate

The difference between the executive and legislative estimates of oil and natural gas production tax stemmed almost entirely from price difference in oil. The October IHS forecast had much higher estimates for oil prices than the November IHS forecast, which assumes the current price weakness is likely to continue. Due to timing of when estimates are published, this abnormally large price change affected the estimates greatly.



Legislative Options

While the legislative estimate for oil & natural gas production tax is closely tied to the IHS forecast of West Texas Intermediate (WTI) oil price and Henry Hub (HH) natural gas price, the tax committees may wish to explore options regarding the forecast of new drilling in the state. The RTIC estimate assumes an average of 10 oil drilling rigs per month throughout the forecast period. The adjacent table summarizes the revenue impact of assuming alternative drilling rig assumptions.

General Fund Impact of Including Alternative Numbers of Oil Rigs
($ Millions)

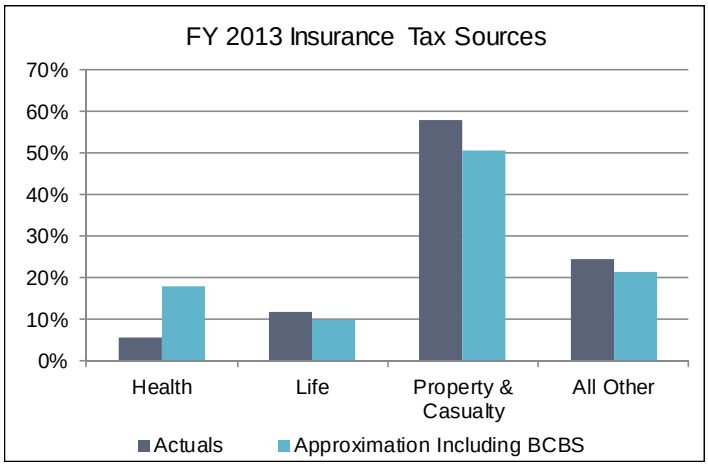
Number of Rigs	FY 2015	FY 2016	FY 2017	3-Year Total
0	($0.018)	($5.294)	($11.080)	($16.392)
5	(0.846)	(2.647)	(5.540)	(9.033)
10	-	-	-	-
20	1.692	5.294	11.080	18.066

Insurance Tax

The majority of insurance tax collections come from 2.75% of net premiums sold. There is an additional 2.5% levied on fire insurance premiums sold, and a number of small fees.

Two FY 2014 changes impacted this revenue source: Blue Cross and Blue Shield (BCBS) was bought out by Health Care Services Corporation (HCSC) at the beginning of FY 2014 under terms that made all of its policies taxable where they had previously been exempt; and the implementation of the Affordable Care Act.

The adjacent chart illustrates changing share of insurance tax sources with the inclusion of former BCBS premiums.



Although the RTIC estimate includes those who became insured during the ACA open enrollment last year, if there are additional enrollees in the upcoming years, revenues may increase slightly above the estimate.