HOUSE BILL NO. 559

INTRODUCED BY R. HEINERT, CURTISS, JACKSON, L. JONES, W. JONES, LAMBERT, MCNUTT, VINCENT

A BILL FOR AN ACT ENTITLED: "AN ACT INCREASING THE EXEMPTION OF PENSION AND ANNUITY INCOME FROM ADJUSTED GROSS INCOME FOR INDIVIDUAL INCOME TAX PURPOSES; INCREASING THE EXEMPTION OF PENSION AND ANNUITY INCOME ~~FOR TAXPAYERS FILING SINGLY AND AS HEAD OF HOUSEHOLD; INCREASING THE EXEMPTION OF PENSION AND ANNUITY INCOME FOR MARRIED TAXPAYERS~~ BASED ON FILING STATUS; INCREASING THE FEDERAL ADJUSTED GROSS INCOME AMOUNT RELATED TO THE PHASEOUT FOR MARRIED TAXPAYERS FILING JOINTLY; ADJUSTING THE EXEMPTION AMOUNTS FOR INFLATION; ADJUSTING FOR INFLATION THE FEDERAL ADJUSTED GROSS INCOME AMOUNTS RELATED TO THE PHASEOUT OF THE EXEMPTION AMOUNTS; AMENDING SECTIONS 15-30-111, 15-62-207, 15-62-208, 19-2-1004, 19-17-407, 19-18-612, 19-19-504, 19-20-706, AND 19-21-212, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND A RETROACTIVE APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Section 15-30-111, MCA, is amended to read:

"15-30-111. Adjusted gross income. (1) Adjusted gross income is the taxpayer's federal adjusted gross income as defined in section 62 of the Internal Revenue Code, 26 U.S.C. 62, and in addition includes the following:

(a) (i) interest received on obligations of another state or territory or county, municipality, district, or other political subdivision of another state, except to the extent that the interest is exempt from taxation by Montana under federal law; and

(ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code, 26 U.S.C. 852(b)(5), that are attributable to the interest referred to in subsection (1)(a)(i);

(b) refunds received of federal income tax, to the extent that the deduction of the tax resulted in a reduction of Montana income tax liability;

(c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue Code that has been reduced by any federal taxes paid by the subchapter S. corporation on the income;

(d) depreciation or amortization taken on a title plant as defined in 33-25-105;

(e) the recovery during the tax year of an amount deducted in any prior tax year to the extent that the amount recovered reduced the taxpayer's Montana income tax in the year deducted;

(f) if the state taxable distribution of an estate or trust is greater than the federal taxable distribution of the same estate or trust, the difference between the state taxable distribution and the federal taxable distribution of the same estate or trust for the same tax period; and

(g) except for exempt-interest dividends described in subsection (2)(a)(ii), for tax years commencing after December 31, 2002, the amount of any dividend to the extent that the dividend is not included in federal adjusted gross income.

(2) Notwithstanding the provisions of the Internal Revenue Code, adjusted gross income does not include the following, which are exempt from taxation under this chapter:

(a) (i) all interest income from obligations of the United States government, the state of Montana, or a county, municipality, district, or other political subdivision of the state and any other interest income that is exempt from taxation by Montana under federal law; and

(ii) exempt-interest dividends as defined in section 852(b)(5) of the Internal Revenue Code, 26 U.S.C. 852(b)(5), that are attributable to the interest referred to in subsection (2)(a)(i);

(b) interest income earned by a taxpayer who is 65 years of age or older in a tax year up to and including $800 for a taxpayer filing a separate return and $1,600 for each joint return;

(c) (i) except as provided in subsection (2)(c)(ii), ~~the first $3,600~~ an amount of all pension and annuity income received as defined in 15-30-101 as follows:

(A) the first $5,400, as adjusted under subsection (9), for each taxpayer filing singly, ~~or~~ head of household, OR MARRIED FILING SEPARATELY; or

(B) the first $8,000, as adjusted under subsection (9), for ~~each~~ married ~~taxpayer~~ TAXPAYERS filing jointly ~~or separately~~;

(ii) for pension and annuity income described under subsection (2)(c)(i), as follows:

(A) each taxpayer filing singly, head of household, or married filing separately shall reduce the total amount of the exclusion amounts provided in subsection (2)(c)(i) by $2 for every $1 of federal adjusted gross income in excess of $30,000, as adjusted under subsection (9), as shown on the taxpayer's return;

(B) in the case of married taxpayers filing jointly, if both taxpayers are receiving pension or annuity income or if only one taxpayer is receiving pension or annuity income, the exclusion claimed as provided in subsection (2)(c)(i) must be reduced by $2 for every $1 of federal adjusted gross income in excess of ~~$30,000~~

$38,000, as adjusted under subsection (9), as shown on their joint return;

(d) all Montana income tax refunds or tax refund credits;

(e) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);

(f) all tips or gratuities that are covered by section 3402(k) or service charges that are covered by section 3401 of the Internal Revenue Code of 1954, 26 U.S.C. 3402(k) or 3401, as amended and applicable on January 1, 1983, received by ~~persons~~ a person for rendering services ~~rendered by them~~ to patrons of premises licensed to provide food, beverage, or lodging;

(g) all benefits received under the workers' compensation laws;

(h) all health insurance premiums paid by an employer for an employee if attributed as income to the employee under federal law;

(i) all money received because of a settlement agreement or judgment in a lawsuit brought against a manufacturer or distributor of "agent orange" for damages resulting from exposure to "agent orange";

(j) principal and income in a medical care savings account established in accordance with 15-61-201 or withdrawn from an account for eligible medical expenses, as defined in 15-61-102, of the taxpayer or a dependent of the taxpayer or for the long-term care of the taxpayer or a dependent of the taxpayer;

(k) principal and income in a first-time home buyer savings account established in accordance with 15-63-201 or withdrawn from an account for eligible costs, as provided in 15-63-202(7), for the first-time purchase of a single-family residence;

(l) contributions withdrawn from a family education savings account or earnings withdrawn from a family education savings account for qualified higher education expenses, as defined in 15-62-103, of a designated beneficiary;

(m) the recovery during the tax year of any amount deducted in any prior tax year to the extent that the recovered amount did not reduce the taxpayer's Montana income tax in the year deducted;

(n) if the federal taxable distribution of an estate or trust is greater than the state taxable distribution of the same estate or trust, the difference between the federal taxable distribution and the state taxable distribution of the same estate or trust for the same tax period;

(o) deposits, not exceeding the amount set forth in 15-30-603, deposited in a Montana farm and ranch risk management account, as provided in 15-30-601 through 15-30-605, in any tax year for which a deduction is not provided for federal income tax purposes;

(p) income of a dependent child that is included in the taxpayer's federal adjusted gross income pursuant to the Internal Revenue Code. The child is required to file a Montana personal income tax return if the child and taxpayer meet the filing requirements in 15-30-142.

(q) principal and income deposited in a health care expense trust account, as defined in 2-18-1303, or withdrawn from the account for payment of qualified health care expenses as defined in 2-18-1303; and

(r) that part of the refundable credit provided in 33-22-2006 that reduces Montana tax below zero.

(3) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(l) shall include in the shareholder's adjusted gross income the earnings and profits of the DISC in the same manner as provided by section 995 of the Internal Revenue Code, 26 U.S.C. 995, for all periods for which the DISC election is effective.

(4) A taxpayer who, in determining federal adjusted gross income, has reduced the taxpayer's business deductions by an amount for wages and salaries for which a federal tax credit was elected under sections 38 and 51(a) of the Internal Revenue Code, 26 U.S.C. 38 and 51(a), is allowed to deduct the amount of the wages and salaries paid regardless of the credit taken. The deduction must be made in the year that the wages and salaries were used to compute the credit. In the case of a partnership or small business corporation, the deduction must be made to determine the amount of income or loss of the partnership or small business corporation.

(5) Married taxpayers filing a joint federal return who are required to include part of their social security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be split equally on the Montana return.

(6) A taxpayer receiving retirement disability benefits who has not attained 65 years of age by the end of the tax year and who has retired as permanently and totally disabled may exclude from adjusted gross income up to $100 a week received as wages or payments in lieu of wages for a period during which the employee is absent from work due to the disability. If the adjusted gross income before this exclusion exceeds $15,000, the excess reduces the exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the limitation for income exceeding $15,000 is determined with respect to the spouses on their combined adjusted gross income. For the purpose of this subsection, "permanently and totally disabled" means unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment lasting or expected to last at least 12 months.

~~(7) Married taxpayers who file a joint federal return and who make an election on the federal return to defer income ratably for 4 tax years because of a conversion from an IRA other than a Roth IRA to a Roth IRA,~~

~~pursuant to section 408A(d)(3) of the Internal Revenue Code, 26 U.S.C. 408A(d)(3), may file separate Montana income tax returns to defer the full taxable conversion amount from Montana adjusted gross income for the same time period. The deferred amount must be attributed to the taxpayer making the conversion.~~

~~(8)~~(7) An individual who contributes to one or more accounts established under the Montana family education savings program may reduce adjusted gross income by the lesser of $3,000 or the amount of the contribution. In the case of married taxpayers, each spouse is entitled to a reduction, not in excess of $3,000, for the spouses' contributions to the accounts. Spouses may jointly elect to treat half of the total contributions made by the spouses as being made by each spouse. The reduction in adjusted gross income under this subsection applies only with respect to contributions to an account of which the account owner, as defined in 15-62-103, is the taxpayer, the taxpayer's spouse, or the taxpayer's child or stepchild if the taxpayer's child or stepchild is a Montana resident. The provisions of subsection (1)(e) do not apply with respect to withdrawals of contributions that reduced adjusted gross income.

~~(9)~~(8) (a) A taxpayer may exclude the amount of the loan payment received pursuant to subsection ~~(9)(a)(iv)~~ (8)(a)(iv), not to exceed $5,000, from the taxpayer's adjusted gross income if the taxpayer:

(i) is a health care professional licensed in Montana as provided in Title 37;

(ii) is serving a significant portion of a designated geographic area, special population, or facility population in a federally designated health professional shortage area, a medically underserved area or population, or a federal nursing shortage county as determined by the secretary of health and human services or by the governor;

(iii) has had a student loan incurred as a result of health-related education; and

(iv) has received a loan payment during the tax year made on the taxpayer's behalf by a loan repayment program described in subsection ~~(9)(b)~~ (8)(b) as an incentive to practice in Montana.

(b) For the purposes of subsection ~~(9)(a)~~ (8)(a), a loan repayment program includes a federal, state, or qualified private program. A qualified private loan repayment program includes a licensed health care facility, as defined in 50-5-101, that makes student loan payments on behalf of the person who is employed by the facility as a licensed health care professional.

(9) (a) The department, by November 1 of each year, shall multiply the exemption amounts for pension and annuity income referred to in subsections (2)(c)(i)(A) and (2)(c)(i)(B) by the RATIO OF THE inflation factor for that tax year TO THE INFLATION FACTOR FOR TAX YEAR 2007 and round the product to the nearest $10. The resulting adjusted exemptions are effective for that tax year and must be used in calculating the tax imposed in 15-30-103.

(b) The department, by November 1 of each year, shall multiply the federal adjusted gross income figures referred to in subsections (2)(c)(ii)(A) and (2)(c)(ii)(B) by the RATIO OF THE inflation factor for that tax year TO THE INFLATION FACTOR FOR TAX YEAR 2007 and round the product to the nearest $10. The resulting federal adjusted gross income figures are effective for that tax year and must be used in calculating the tax imposed in 15-30-103.

~~(c) For the purposes of this subsection (9), "inflation factor" means a number determined for each tax year by dividing the consumer price index for June of the tax year by the consumer price index for June 2007.~~

(Subsection (2)(f) terminates on occurrence of contingency--sec. 3, Ch. 634, L. 1983; subsection (2)(o) terminates on occurrence of contingency--sec. 9, Ch. 262, L. 2001.)"

Section 2. Section 15-62-207, MCA, is amended to read:

"15-62-207. Deductions for contributions. An individual who contributes to one or more accounts in a tax year is entitled to reduce the individual's adjusted gross income, in accordance with 15-30-111~~(8)~~(7), by the total amount of the contributions, but not more than $3,000. The contribution must be made to an account owned by the contributor, the contributor's spouse, or the contributor's child or stepchild if the contributor's child or stepchild is a Montana resident."

Section 3. Section 15-62-208, MCA, is amended to read:

"15-62-208. Tax on certain withdrawals of deductible contributions. (1) There is a recapture tax at a rate equal to the highest rate of tax provided in 15-30-103 on the recapturable withdrawal of amounts that reduced adjusted gross income under 15-30-111~~(8)~~(7).

(2) For purposes of determining the portion of a recapturable withdrawal that reduced adjusted gross income, all withdrawals must be allocated between income and contributions in accordance with the principles applicable under section 529(c)(3)(A) of the Internal Revenue Code ~~of 1986~~, 26 U.S.C. 529(c)(3)(A). The portion of a recapturable withdrawal that is allocated to contributions must be treated as derived first from contributions, if any, that did not reduce adjusted gross income, to the extent of those contributions, and then to contributions that reduced adjusted gross income. The portion of any other withdrawal that is allocated to contributions must be treated as first derived from contributions that reduced adjusted gross income, to the extent of the contributions, and then to contributions that did not reduce adjusted gross income.

(3) (a) The recapture tax imposed by this section is payable by the owner of the account from which the withdrawal or contribution was made. The tax liability must be reported on the income tax return of the account owner and is payable with the income tax payment for the year of the withdrawal or at the time that an income tax payment would be due for the year of the withdrawal. The account owner is liable for the tax even if the

account owner is not a Montana resident at the time of the withdrawal.

(b) The department may require withholding on recapturable withdrawals from an account that was at one time owned by a Montana resident if the account owner is not a Montana resident at the time of the withdrawal. For the purposes of this subsection (3)(b), amounts rolled over from an account that was at one time owned by a Montana resident must be treated as if the account is owned by a resident of Montana.

(4) For the purposes of this section, all contributions made to accounts by residents of Montana are presumed to have reduced the contributor's adjusted gross income unless the contributor can demonstrate that all or a portion of the contributions did not reduce adjusted gross income. Contributors who claim deductions for contributions shall report on their Montana income tax returns the amount of deductible contributions made to accounts for each designated beneficiary and the social security number of each designated beneficiary.

(5) As used in this section, "recapturable withdrawal" means a withdrawal or distribution that is a nonqualified withdrawal or a withdrawal or distribution from an account that was opened after the later of:

(a) April 30, 2001; or

(b) the date that is 3 years prior to the date of the withdrawal or distribution.

(6) The department shall use all means available for the administration and enforcement of income tax laws in the administration and enforcement of this section."

Section 4. Section 19-2-1004, MCA, is amended to read:

"19-2-1004. Exemption from taxes and legal process. Except as provided in 19-2-907 and 19-2-909, the right of a person to any benefit or payment from a retirement system or plan and the money in the system or plan's pension trust fund is not:

(1) subject to execution, garnishment, attachment, or any other process;

(2) subject to state, county, or municipal taxes except for:

(a) a benefit or annuity received in excess of: ~~$3,600~~

(i) $5,400 for a person described in 15-30-111(2)(c)(i)(A) or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9); or

(ii) $8,000 for a person described in 15-30-111(2)(c)(i)(B) or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9); or

(b) a refund of a member's regular contributions picked up by an employer after June 30, 1985, as provided in 19-3-315, 19-5-402, 19-6-402, 19-7-403, 19-8-502, 19-9-710, or 19-13-601; or

(3) assignable except as specifically provided in this chapter."

Section 5. Section 19-17-407, MCA, is amended to read:

"19-17-407. Exemption from taxation and legal process. (1) The ~~first $3,600 or the amount determined pursuant to 15-30-111(2)(c)(ii) of~~ following benefits received under this part ~~is~~ are exempt from state, county, and municipal taxation:

(a) the first $5,400 received by a person described in 15-30-111(2)(c)(i)(A) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9); or

(b) the first $8,000 received by a person described in 15-30-111(2)(c)(i)(B) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9).

(2) Benefits received under this part are not subject to execution, garnishment, attachment, or any other process."

Section 6. Section 19-18-612, MCA, is amended to read:

"19-18-612. Protection of benefits from legal process and taxation -- nonassignability. (1) Except for execution or withholding for the payment of child support or for the payment of spousal support for a spouse or former spouse who is the custodial parent of the child, payments made or to be made under this chapter are not subject to judgments, garnishment, execution, or other legal process. A person entitled to a pension may not assign the right, and the association and trustees may not recognize any assignment or pay over any sum assigned.

(2) The ~~first $3,600 or the amount determined pursuant to 15-30-111(2)(c)(ii) of~~ following benefits received under this part ~~is~~ are exempt from state, county, and municipal taxation:

(a) the first $5,400 received by a person described in 15-30-111(2)(c)(i)(A) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9); or

(b) the first $8,000 received by a person described in 15-30-111(2)(c)(i)(B) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9)."

Section 7. Section 19-19-504, MCA, is amended to read:

"19-19-504. Protection of benefits from legal process and taxation. (1) Except for execution or withholding for the payment of child support or for the payment of spousal support for a spouse or former spouse who is the custodial parent of the child, the benefits provided for in this part are not subject to execution, garnishment, attachment, or the operation of bankruptcy, insolvency, or other process of law and are unassignable except as specifically provided in 19-19-505.

(2) The ~~first $3,600 or the amount determined pursuant to 15-30-111(2)(c)(ii) of~~ following benefits received under this part ~~is~~ are exempt from state, county, and municipal taxation:

(a) the first $5,400 received by a person described in 15-30-111(2)(c)(i)(A) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9); or

(b) the first $8,000 received by a person described in 15-30-111(2)(c)(i)(B) or the amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9)."

Section 8. Section 19-20-706, MCA, is amended to read:

"19-20-706. Exemption from taxation and legal process. Except as provided in 19-20-305 and 19-20-306, the retirement allowances or any other benefits accrued or accruing to any person under the provisions of the retirement system and the accumulated contributions and cash and securities in the various funds of the retirement system are:

(1) exempted from any state, county, or municipal tax of the state of Montana except for:

(a) (i) a retirement allowance received by a person described in 15-30-111(2)(c)(i)(A) in excess of ~~$3,600~~ $5,400 or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9); or

(ii) a retirement allowance received by a person described in 15-30-111(2)(c)(i)(B) in excess of $8,000 or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9); or

(b) a withdrawal paid under 19-20-603 of a member's contributions picked up by an employer after June 30, 1985, as provided in 19-20-602;

(2) not subject to execution, garnishment, attachment by trustee process or otherwise, in law or equity, or any other process; and

(3) unassignable except as specifically provided in this chapter."

Section 9. Section 19-21-212, MCA, is amended to read:

"19-21-212. Exemption from taxation, legal process, and assessments. Except for execution or withholding for the payment of child support or for the payment of spousal support for a spouse or former spouse who is the custodial parent of the child, contracts, benefits, and contributions under the optional retirement program and the earnings on the contributions are:

(1) (a) except for a retirement allowance received by a person described in 15-30-111(2)(c)(i)(A) in excess of ~~$3,600~~ $5,400 or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) and (9), exempt from any state, county, or municipal tax; or

(b) except for a retirement allowance received by a person described in 15-30-111(2)(c)(i)(B) in excess of $8,000 or adjusted by an amount determined pursuant to 15-30-111(2)(c)(ii)(A) or (2)(c)(ii)(B), as applicable, and (9), exempt from any state, county, or municipal tax;

(2) not subject to execution, garnishment, attachment, or other process;

(3) not covered or assessable by an insurance guaranty association; and

(4) unassignable except as specifically provided in the contracts."

NEW SECTION. **Section 10. Saving clause.** [This act] does not affect rights and duties that matured, penalties that were incurred, or proceedings that were begun before [the effective date of this act].

NEW SECTION. **Section 11. Effective date.** [This act] is effective on passage and approval.

NEW SECTION. **Section 12. Retroactive applicability.** [This act] applies retroactively, within the meaning of 1-2-109, to tax years beginning after December 31, 2006.

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