GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2015 Biennium

Bill #	SB0282	**Title:**	Generally revise taxation of income, including the corporate license tax
Primary Sponsor:	Tutvedt, Bruce	**Status:**	As Amended in House Committee

- ☐ 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	$81,000	($758,920)	($966,676)	($978,075)
Revenue:				
General Fund	($27,033,000)	($71,100,000)	($71,210,000)	($77,612,000)
Net Impact-General Fund Balance:	($27,114,000)	($70,341,080)	($70,243,324)	($76,633,925)

Description of fiscal impact: This bill would revise the structure of the individual income tax, eliminate several credits against individual income tax and corporation license tax, reduce the corporation license tax rates, and eliminate the contractors' gross receipts tax. Department of Revenue costs would ultimately be reduced by about $1 million per year. As amended, the combined effect of these changes would reduce general fund revenue by $98 million in the 2015 biennium and by $149 million in the 2017 biennium.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. Beginning in CY 2014, SB 282 would revise the structure of the individual income tax, reduce rates for the corporation license tax, eliminate several credits and deductions for individuals and corporations, and eliminate the public contractors' gross receipts tax.
2. SB 282 would make federal taxable income, with a short list of adjustments, the base for the individual income tax.
3. The bill would make taxable income subject to two rates, 3.5% and 5.75%, with separate rate tables for taxpayers who file a joint return, who file as head of household, and who file as single or married separate. SB 282 also would replace the capital gains credit with lower rates for capital gains.

4. The income tax forecasting model was modified to reflect the provisions of SB282. The following table shows the difference between calendar year tax liability from the modified model and model output under current law.

Year	Reduction in Tax Liability ($ millions)
2014	($67.750)
2015	($72.755)
2016	($80.783)
2017	($86.811)

5. SJ 2 allocates calendar year income tax liability equally between two fiscal years. SB 282 would take effect at the start of CY 2014, which is the middle of FY 2014. Thus, tax liability would be reduced for only half of FY 2014. The department would develop new income tax withholding schedules and provide them to employers in the fall of 2013. However, based on experience with previous rate changes, some employers are expected to take several months to begin using the new withholding schedules. These employers will over-withhold income tax during the second half of FY 2014, and their employees will have this over-withheld tax refunded in FY 2015 when they file their 2014 tax returns. Because of this, it is assumed that one-third of the revenue reduction expected for FY 2014 will actually occur in FY 2015. The left-hand column of the following table shows the calendar year differences in tax liability in assumption #4 allocated evenly between fiscal years. The right-hand column shows revenue changes with part of the change that should occur in FY 2014 shifted to FY 2015 because of the slow adoption of withholding tables.

Change in Revenue ($ millions)

Fiscal Year	If Withholding Tables Adopted Immediately	With Likely Slow Adoption
FY 2014	($33.875)	($22.583)
FY 2015	($70.252)	($81.544)
FY 2016	($76.769)	($76.769)
FY 2017	($83.797)	($83.797)

6. SB 282 would eliminate several credits and deductions that are allowed against individual income tax and corporate license tax. The following table shows provisions that are eliminated and the amount that each reduced revenue in the latest year for which all returns have been filed. SB 282 would also eliminate several corporate deductions that are not reported on separate lines on the return. The impact of these deductions is unknown but is expected to be small.

Revenue Impact of Eliminated Credits and Deductions - Last Year of Actual Returns

	Individual Income Tax 2011	Corporate License Tax 2010
Empowerment Zone Credit	$475	n/a
Alternative Fuel Conversion Credit	$27,322	$14,000
New or Expanded Industry Credit	n/a	$0
Geothermal Heating System Credit	$327,275	$0
Alternative Energy Production Credit	$7,290	$100
Mineral Exploration Credit	$0	$25
Recycling Credit	$583,873	$47,884
Recycling Deduction	n/a	$4,974,408
Biodiesel Credits	$55,292	$0
Contractors' Gross Receipts Tax Credit	$4,426,212	$906,127
Total	**$5,427,739**	**$5,942,544**

7. The revenue impact of eliminating credits and deductions would first show up when taxpayers file their TY 2014 returns in FY 2015. In SJ 2, income tax credits are forecast as a group and corporate license tax credits are not explicitly forecast. The following table shows the revenue impacts of eliminating credits and deductions assuming that the income tax credits would grow at the rate forecast in SJ 2 and that the revenue impact of corporate credits and deductions would be proportional to the SJ 2 corporation license tax forecast. Corporation license tax revenue is assumed to be the same in FY 2016 and FY 2017 as in FY 2015. The following table shows the revenue impact of eliminating credits and deductions.

Revenue Impact of Eliminated Credits and Deductions ($ millions)

	FY 2014	FY 2015	FY 2016	FY 2017
Individual Income Tax	$0.000	$7.967	$8.550	$9.176
Corporation License Tax	$0.000	$5.943	$5.943	$5.943

8. SB 282 would eliminate the public contractors' gross receipts tax beginning in CY 2014. This would eliminate half of projected revenue for FY 2014 and all of projected revenue for later years. The following table shows the revenue impact, assuming that revenue in FY 2016 and FY 2017 would be the same as is forecast for FY 2015.

Revenue Impact of Eliminating Contractors' Gross Receipts Tax ($ millions)

FY 2014	FY 2015	FY 2016	FY 2017
($1.630)	($3.259)	($3.259)	($3.259)

9. Under current law, individual taxpayers are required to make a number of adjustments to federal adjusted gross income. Some of these require taxpayers to carry adjustments made in one year forward to a future year. SB 282 requires taxpayers to use any carried-forward adjustments in filing their TY 2014 tax returns. In most cases, some taxpayers will have positive adjustments, others will have negative adjustments, and the two will approximately cancel. One adjustment that will increase taxable income for many taxpayers with no offsetting decreases is refunds of federal income tax that was used as part of the taxpayer's itemized deduction for federal taxes in a previous year. Adjustments on TY 2011 income tax returns were used to estimate adjustments that would be carried forward and used in TY 2014. The net taxable income of additions and subtractions is estimated to be $100.699 million. The average marginal tax rate for taxpayers with adjustments in TY 2014 would be 5.43%. The net effect of adjustments carried forward and used in TY 2014 would be to increase revenue by $5.468 million.
10. SB 282 would reduce the corporate license tax rate to 6.5% for most corporations and to 6.75% for corporations that make the water's-edge election. Tax liability was recalculated for the latest available year of returns using the rates in this bill and found to be 96.3% of tax liability under current law. It is assumed that tax liability under SB 282 would be 96.3% of the SJ 2 forecast. Since SB 282 would go into effect in the middle of FY 2014, this revenue reduction applies for only half of the fiscal year, and revenue for FY 2014 would be 98.17% of the SJ 2 forecast. Revenue for FY 2016 and FY 2017 is assumed to be the same as the forecast for FY 2015. The following table shows projected corporation license tax revenue under current law, under SB 282, and the difference.

Corporation License Tax Revenue ($ millions)

	Current Law	SB282	Difference
FY 2014	$154.096	$151.276	-$2.820
FY 2015	$155.022	$149.348	-$5.674
FY 2016	$155.022	$149.348	-$5.674
FY 2017	$155.022	$149.348	-$5.674

11. The following table shows the revenue impact of each component of SB 282 and the total revenue impact.

Net Change in General Fund Revenue

	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**
Income Tax Restructuring	($22.583)	($81.544)	($76.769)	($83.797)
Elimination of Income Tax Credits	$0.000	$7.967	$8.550	$9.176
Income Tax Transition Provisions	$0.000	$5.468	$0.000	$0.000
Corporate Tax Rate Change	($2.820)	($5.674)	($5.674)	($5.674)
Elimination of Corporate Credits and Deductions	$0.000	$5.943	$5.943	$5.943
Eliminate Contractors' Gross Receipts Tax	($1.630)	($3.259)	($3.259)	($3.259)
Total	**($27.033)**	**($71.100)**	**($71.210)**	**($77.612)**

12. This bill would take effect at the beginning of CY 2014. Elimination of the contractors' gross receipts tax and several tax credits will reduce the need to audit returns and answer taxpayer inquiries. Using federal taxable income as the starting point for the income tax return will make the return shorter and is expected to reduce the number of errors on returns that the department has to correct by about half. The department expects to be able to eliminate 3.00 FTE auditing positions during FY 2015. Another 2.00 FTE positions would be eliminated at the beginning of FY 2016. Personal services costs would be reduced by $136,983 in FY 2015, $233,877 in FY 2016, and $238,335 in FY 2017. Operating cost savings would be $4,416 in FY 2015, $7,470 in FY 2016, and $7,580 in FY 2017.
13. With a shorter form, data entry and other processing of income tax returns would be reduced. The department would be able to eliminate 4.00 FTE and hire fewer temporary workers on contract during the processing season. Personal services costs would be reduced by $129,078 in FY 2015, $131,483 in FY 2016, and $133,933 in FY 2017. Operating expenses, including contract temporaries, would be reduced by $107,808 in FY 2015, $107,896 in FY 2016, and $107,984 in FY 2017.
14. Changes to the department's data capture and data processing systems to accommodate changed income tax returns would be made in FY 2014 at a cost of $81,000. Beginning in FY 2015, the annual workload for maintaining and updating the income tax modules of the department's data capture and data processing systems would be reduced by 10%. This would allow the department to eliminate 1.00 FTE position and reduce purchase of contracted services from the system vendors by $250,000. Personal services costs would be reduced by $51,876 in FY 2015, $52,870 in FY 2016, and $53,882 in FY 2017. Operating expenses, including contracted services, would be reduced by $251,472 in FY 2015, $251,494 in FY 2016, and $251,516 in FY 2017.
15. With fewer credits and a simpler income tax form, the department will have fewer disputes with taxpayers and will be able to eliminate 1.00 FTE lawyer at the beginning of FY 2016. Personal service costs would be reduced by $83,651 in FY 2016 and $85,280 in FY 2017. Operating costs would be reduced by $1,494 in 2016 and $1,516 in FY 2017.
16. Income tax booklets would have fewer pages, and the department would produce only one version of the form and instructions instead of the existing Form 2, Form 2M, and Form 2EZ. Printing and mailing costs would be reduced by $7,500 per year beginning in FY 2015.
17. With a simpler form and fewer credits, less staff time would be required for the annual form revision process and there would be fewer questions from taxpayers during the filing season. The department would eliminate 0.50 FTE a position from forms design and 1.00 FTE position from the call center in FY 2015 and an additional 0.50 FTE a position from the call center in FY 2016. Personal services costs would be reduced by $62,415 in FY 2015, $81,547 in FY 2016, and $83,133 in FY 2017. Operating costs would be reduced by $7,372 in FY 2015, $7,394 in FY 2016, and $7,416 in FY 2017.

Fiscal Impact:	**FY 2014 Difference**	**FY 2015 Difference**	**FY 2016 Difference**	**FY 2017 Difference**
Department of Revenue				
FTE	0.00	(9.50)	(13.00)	(13.00)
Expenditures:				
Personal Services	$0	($380,352)	($583,428)	($594,563)
Operating Expenses	$81,000	($378,568)	($383,248)	($383,512)
TOTAL Expenditures	$81,000	($758,920)	($966,676)	($978,075)
Funding of Expenditures:				
General Fund (01)	$81,000	($758,920)	($966,676)	($978,075)
TOTAL Funding of Exp.	$81,000	($758,920)	($966,676)	($978,075)
Revenues:				
General Fund (01)	($27,033,000)	($71,100,000)	($71,210,000)	($77,612,000)
TOTAL Revenues	($27,033,000)	($71,100,000)	($71,210,000)	($77,612,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($27,114,000)	($70,341,080)	($70,243,324)	($76,633,925)

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