



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2017 Biennium

Bill #	SB0166
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Title:	Eliminate the waters edge election for corporate income tax filers
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Primary Sponsor:	Barrett, Dick
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Status:	As Introduced
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| <input type="checkbox"/> Significant Local Gov Impact | <input type="checkbox"/> Needs to be included in HB 2 | <input checked="" type="checkbox"/> Technical Concerns |
| <input type="checkbox"/> Included in the Executive Budget | <input type="checkbox"/> Significant Long-Term Impacts | <input type="checkbox"/> Dedicated Revenue Form Attached |

FISCAL SUMMARY

	<u>FY 2016 Difference</u>	<u>FY 2017 Difference</u>	<u>FY 2018 Difference</u>	<u>FY 2019 Difference</u>
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:	<u>\$2,000,000</u>	<u>\$4,000,000</u>	<u>\$6,000,000</u>	<u>\$8,000,000</u>

Description of fiscal impact: The bill proposes to eliminate the water's-edge election for corporate income taxpayers. The change is estimated to increase general fund revenues by \$6 million in the 2017 biennium, and then eventually \$8 million per year, phased in over several years, as current elections expire.

FISCAL ANALYSIS

Assumptions:

- Under current state law, C corporations doing business in the state, and that have Montana source income, are subject to the corporate income tax. In the case of corporations with many member companies or subsidiaries, state law requires those that have common ownership, and that are part of a common line of business, file a combined report. The purpose of a combined group report is to make the apportionment of income to Montana independent of the financial or legal arrangements between group members, and to more accurately reflect the business income of the total enterprise.
- If all 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, Montana does not tax all the income of the combined group, but only the income apportioned to Montana using the apportionment factor. Sales, property, and payroll are the three factors used to

apportion taxable income to Montana. The apportionment factor is a ratio based on the taxpayer’s sales, property, and payroll in Montana relative to the taxpayer’s total sales, property, and payroll.

3. 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 certain members of its foreign affiliates are included in the combined report.
4. 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 (DOR). In the most recent, complete tax year database of returns, 365 of the 16,790 corporations filing Montana corporate income tax returns elected to file as water’s-edge taxpayers.
5. 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.
6. Based upon audit experience and other research, eliminating the water’s-edge election entirely has been estimated to result in a net revenue increase of anywhere from \$8 to \$13 million in general fund revenue. For purposes of this fiscal note, the revenue change is assumed to be \$8 million per year.
7. 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.
8. For purposes of this fiscal note, 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 2016, \$4 million in FY 2017, \$6 million in FY 2018, and \$8 million in FY 2019 and all years thereafter.
9. The changes proposed in the bill require system changes and associated testing and form changes. It is anticipated the changes will be made as part of the annual forms change process.

	<u>FY 2016 Difference</u>	<u>FY 2017 Difference</u>	<u>FY 2018 Difference</u>	<u>FY 2019 Difference</u>
<u>Fiscal Impact:</u>				
<u>Expenditures:</u>				
Operating Expenses	\$0	\$0	\$0	\$0
TOTAL Expenditures	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<u>Funding of Expenditures:</u>				
General Fund (01)	\$0	\$0	\$0	\$0
TOTAL Funding of Exp.	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<u>Revenues:</u>				
General Fund (01)	\$2,000,000	\$4,000,000	\$6,000,000	\$8,000,000
TOTAL Revenues	<u>\$2,000,000</u>	<u>\$4,000,000</u>	<u>\$6,000,000</u>	<u>\$8,000,000</u>
<u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u>				
General Fund (01)	\$2,000,000	\$4,000,000	\$6,000,000	\$8,000,000

Technical Notes:

1. Corporate income tax revenue is subject to substantial volatility which may affect actual collections.

2. The Department of Revenue recommends the following amendments be made to the bill:
 - On Page 1, line 23, following: "made", strike: "before [the effective date of this section]" and insert: "in accordance with [Section 3]. Currently the department requires the taxpayer submit a water's-edge election within the first 90 days of the first tax year of the three-year period. Thus, a calendar year taxpayer would, under current rules, need to submit an election before the end of March.
 - The amended language of section (2) does not reference the 90 day requirement, and begins with the phrase "Notwithstanding any other provisions of law" leaving the possibility that a taxpayer may believe it is entitled to the election if made before the bill is effective, but outside the 90 day window.
3. The Department of Revenue suggests that the language in section 3, part 4, is vestigial transitional language from CY 2003.

Sponsor's Initials

Date

Budget Director's Initials

Date