GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Fiscal Note 2021 Biennium

Bill #	HB0697		**Title:**	Revise individual income tax laws
Primary Sponsor:	Hamilton, Jim		**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 2020 Difference	FY 2021 Difference	FY 2022 Difference	FY 2023 Difference
Expenditures:				
General Fund	$23,400	($64,012)	($226,031)	($229,421)
Revenue:				
General Fund	$7,934,000	$38,285,000	$29,847,000	$26,298,000
Net Impact-General Fund Balance:	$7,910,600	$38,349,012	$30,073,031	$26,527,421

Description of fiscal impact: HB 697 revises Montana's personal income tax by reducing additions and subtractions that convert federal adjusted gross income into Montana adjusted gross income and changes the tax rates and applicable income thresholds. The bill also changes the tax treatment of estates and trusts, and two seldom-used corporate income tax deductions. The proposed changes would increase general fund revenue by $7.9 million in FY 2020, which increases to $26.5 million in FY 2023.

FISCAL ANALYSIS

Assumptions:

Department for Revenue (DOR)

1. Under current law, individuals Montana adjusted gross income consists of adding income from 15 different sources and subtracting income from 35 other sources from their federal adjusted gross income.
2. HB 697 eliminates most of the Montana additions and subtractions from federal income. Under HB 697, the only additions and subtractions that would remain are those required under federal law. Those remaining subtractions would be tribal income, interest on federal bonds, Tier I Railroad Retirement income, as well as reductions for military and veterans' income.
3. HB 697 also eliminates the option to claim itemized deductions in lieu of the state's standard deduction.
4. The standard deduction is changed from 20% of the taxpayer's Montana adjusted gross income to a flat amount, which for TY 2020 is estimated to be $7,590.

5. The additional exemptions for being at least 65 years old, or for being blind, are eliminated.
6. The bill changes the rates and thresholds at which incomes are taxed. Under current law, Montana's personal income tax rates increase as taxable incomes increase, with seven different tax rates. The number of tax rates increase under HB 697 to nine. A breakdown of the present law and HB 697 tax rates are provided in the table below.

Tax Rates and Income Thresholds Under Present Law and HB 697 in TY 2020			
Current Law		HB 697	
Tax Rate	Income Limit	Tax Rate	Income Limit
1.0%	$3,100	0.8%	$3,400
2.0%	$5,500	1.6%	$6,000
3.0%	$8,500	2.4%	$9,100
4.0%	$11,400	3.2%	$12,200
5.0%	$14,600	4.0%	$15,700
6.0%	$18,900	4.8%	$20,300
6.9%	Unlimited	6.3%	$270,900
		6.7%	$541,900
		7.2%	Unlimited

7. HB 697 eliminates the 2 percent capital gains tax credit that applies to all net capital gains income.
8. Most other income tax credits are eliminated. Under current law, taxpayers can claim approximately 26 non-refundable income tax credits and 3 refundable credits. The Montana earned income tax credit will also be available starting TY 2019. Under HB 697, the only income tax credits that would remain would be: the credit for taxes paid to other states, the elderly homeowner / renter credit, and the earned income tax credit.
9. The changes made by HB 697 first apply to TY 2020 and continue to apply to all future tax years.
10. The department's income tax model was modified to include the changes made by HB 697. The tax liability of taxpayers after the capital gains tax credit, but before other tax credits, were estimated under current law and under the proposed bill. For TY 2020, HB 697 would increase income tax revenue before credits by $25.194 million. For TY 2021, TY 2022 and TY 2023, the increase in revenue is $15.243 million, $11.009 million and $7.544 million, respectively.
11. Based on the value of credits claimed in TY 2017, and credit growth in the HJ 2 assumptions, the elimination of the non-capital gains tax credits in HB 697 will increase income tax liabilities by $14.477 million in TY 2020, $14.818 million in TY 2021, $15.301 million in TY 2022 and $16.024 million in TY 2023.
12. When combined, the personal income tax changes made by HB 697 will increase the tax liability of Montana's taxpayers by $39.671 million in TY 2020, $30.061 million in TY 2021, $26.310 million in TY 2022 and $23.568 million in TY 2023.

HB 697 Change in Income Tax Revenue ($ Million)				
Tax Year	TY 2020	TY 2021	TY 2022	TY 2023
Change in Revenue Before Credits	$25.194	$15.243	$11.009	$7.544
Change in Credits	$14.477	$14.818	$15.301	$16.024
Total Change in Revenue	$39.671	$30.061	$26.310	$23.568

13. The proposed changes will affect the tax liability of taxpayers enough such that some taxpayers will change their withholding and estimated payments. The department would issue new withholding schedules to due to the tax changes proposed in HB 697. It is assumed that 20% of income tax liabilities will be collected during the same fiscal year as the tax year. The remaining 80 percent will be collected the following fiscal year.

14. Based on the distributions in the previous assumption, and the revenue amounts in assumption #12, the proposed bill would increase income tax revenue by $7.934 million in FY 2020, $37.749 million in FY 2021, $29.311 million in FY 2022 and $25.762 million in FY 2023.
15. The tax rate, deduction and credit changes made by the proposed bill will impact the tax liabilities of trusts and estates that directly pay income taxes. Based on tax returns for TY 2016, the proposed changes in HB 697 would have increased the income taxes paid by trusts and estates by $536,000.
16. It is assumed that the changes made by HB 697 will increase general fund revenue from estates and trusts by $536,000 each fiscal year, starting FY 2021.
17. HB 697 eliminates the Student Scholarship and Day Care Facility corporate income tax credits.
18. The elimination of both corporate income tax credits will not have an impact on corporate income tax liabilities.
19. With the individual income tax and trust and estate tax changes combined, HB 697 will increase general fund revenue by $7.934 million in FY 2020, $38.285 million in FY 2021, $29.847 million in FY 2022 and $26.298 million in FY 2023.

Administrative Costs

20. The proposed bill will require the department to change its tax forms and integrated tax processing system. The software changes will require $23,400 in expenditures in FY 2020. The reduction in deductions and credits will reduce the number of audit technicians required by the department by 1.00 FTE starting in FY 2021. The department will also be able to reduce 2.00 FTE auditors starting in FY 2022. The FTE reduction of 1.00 FTE in FY 2021 and an additional 2.00 FYE in FY 2022 will reduce the department's total expenditures by $64,012 in FY 2021, $226,031 in FY 2022 and $229,421 in FY 2023.

Fiscal Impact:	**FY 2020 Difference**	**FY 2021 Difference**	**FY 2022 Difference**	**FY 2023 Difference**
Department of Revenue				
FTE	0.00	(1.00)	(3.00)	(3.00)
Expenditures:				
Personal Services	$0	($56,402)	($202,859)	($205,901)
Operating Expenses	$23,400	($7,610)	($23,172)	($23,520)
TOTAL Expenditures	$23,400	($64,012)	($226,031)	($229,421)
Funding of Expenditures:				
General Fund (01)	$23,400	($64,012)	($226,031)	($229,421)
TOTAL Funding of Exp.	$23,400	($64,012)	($226,031)	($229,421)
Revenues:				
General Fund (01)	$7,934,000	$38,285,000	$29,847,000	$26,298,000
TOTAL Revenues	$7,934,000	$38,285,000	$29,847,000	$26,298,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	$7,910,600	$38,349,012	$30,073,031	$26,527,421

Technical Notes:

Public Employees Retirement System and Teacher's Retirement System

1. The amendment to 19-2-1004, MCA, included in Section 56 on page 60 of HB 697 implies that member contributions held by the retirement system as well as the cash and securities in the pension trust are subject to state taxation. This amendment is likely unconstitutional as the Montana Constitution, Part VIII, Section 15, provides that retirement system assets, including income and actuarially required contributions, shall not be encumbered, diverted, reduced, or terminated and shall be held in trust to provide benefits to participants and their beneficiaries and to defray administrative expenses (exclusive benefit rule). Additionally, it is likely that state taxation of pension trust assets would result in disqualification of the retirement systems under Section 401(a) of the Internal Revenue Code which would be in direct conflict with our statutory requirement to retain qualified plan status in 19-2-1010, MCA.
2. If the intent of HB 697 with respect to PERS and TRS retirement benefits is to simply do away with the tax exemption on the first $4,070 of annual benefits, the only language that should be struck from current law is on page 60, line 20, *following* "received" *strike* "in excess of the amount determined pursuant to 15-30-2110(2)(c)".

JAH		TL	3/26/19
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*