



GOVERNOR'S OFFICE OF  
BUDGET AND PROGRAM PLANNING

## Fiscal Note 2021 Biennium

<b>Bill #</b>	SB0141	<b>Title:</b>	Repeal water's-edge election for corporate income tax
<b>Primary Sponsor:</b>	Barrett, Dick	<b>Status:</b>	As Introduced

- |   |  |  |
|---|--|--|
| <input type="checkbox"/> Significant Local Gov Impact     | <input type="checkbox"/> Needs to be included in HB 2  | <input 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 2020</u> <u>Difference</u>	<u>FY 2021</u> <u>Difference</u>	<u>FY 2022</u> <u>Difference</u>	<u>FY 2023</u> <u>Difference</u>
<b>Expenditures:</b>				
General Fund	\$0	\$0	\$0	\$0
<b>Revenue:</b>				
General Fund	\$2,100,000	\$4,200,000	\$6,300,000	\$6,300,000
<b>Net Impact-General Fund Balance:</b>	<u>\$2,100,000</u>	<u>\$4,200,000</u>	<u>\$6,300,000</u>	<u>\$6,300,000</u>

**Description of fiscal impact:** SB 141 eliminates the water's-edge election for corporate income taxpayers. This change is estimated to increase general fund revenues by \$6.3 million per year after all current "water's edge" elections expire.

### FISCAL ANALYSIS

#### Assumptions:

#### **Department of Revenue (DOR)**

- Montana requires C corporations that have common ownership and that are part of a common line of business to file a combined report. The intent of requiring a combined group report is to make the calculation of total taxable income independent of financial or legal arrangements between group members, and to more accurately reflect the business income of the total enterprise.
- The taxable income of the combined or "unitary" group, after adjustments required under state law, is allocated to Montana based upon the apportionment factor of the group. Montana does not tax all the income of a combined group, only the Montana income using the apportionment factor. The apportionment factor is a ratio based on the taxpayer's receipts, property and payroll in Montana, relative to the taxpayer's total receipts, property and payroll.
- If all the 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. Receipts, 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 receipts, property and payroll in Montana relative to the taxpayer's total receipts, property and payroll.

4. 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 of its foreign affiliates are included in the combined report.
5. 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. In the most recent, complete tax year database of returns, 487 of the 16,432 corporations filing Montana corporate income tax returns elected to file as water's edge taxpayers.
6. This bill proposes to repeal the water's edge election but allows any taxpayer with an existing water's edge election to use it until it expires.
7. 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 \$6.3 million in general fund revenue.
8. 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.
9. Because the water's edge election lasts three years, the increase in revenue is assumed to phase in evenly over three fiscal years. Therefore, the revenue increase is assumed to be \$2.1 million in FY 2020, \$4.2 million in FY 2021, \$6.3 million in FY 2022, and \$6.3 million in FY 2023 and all years thereafter.
10. 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.

<b><u>Fiscal Impact:</u></b>	<b><u>FY 2020</u></b>	<b><u>FY 2021</u></b>	<b><u>FY 2022</u></b>	<b><u>FY 2023</u></b>
<b>Department of Revenue</b>	<b><u>Difference</u></b>	<b><u>Difference</u></b>	<b><u>Difference</u></b>	<b><u>Difference</u></b>
<b><u>Expenditures:</u></b>				
<b>TOTAL Expenditures</b>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<b><u>Funding of Expenditures:</u></b>				
<b>TOTAL Funding of Exp.</b>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
<b><u>Revenues:</u></b>				
General Fund (01)	<u>\$2,100,000</u>	<u>\$4,200,000</u>	<u>\$6,300,000</u>	<u>\$6,300,000</u>
<b>TOTAL Revenues</b>	<u>\$2,100,000</u>	<u>\$4,200,000</u>	<u>\$6,300,000</u>	<u>\$6,300,000</u>
<b><u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u></b>				
General Fund (01)	\$2,100,000	\$4,200,000	\$6,300,000	\$6,300,000

DB

Sponsor's Initials

1/29/19

Date

TL

Budget Director's Initials

1/24/19

Date