



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2023 Biennium

Bill # HB0111

Title: Revise income tax law to exempt military pensions

Primary Sponsor: Fuller, John

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

	<u>FY 2022 Difference</u>	<u>FY 2023 Difference</u>	<u>FY 2024 Difference</u>	<u>FY 2025 Difference</u>
Expenditures:				
General Fund	\$0	\$0	\$0	\$0
Revenue:				
General Fund	(\$1,883,000)	(\$3,167,000)	(\$4,945,000)	(\$6,800,000)
Net Impact-General Fund Balance:	<u>(\$1,883,000)</u>	<u>(\$3,167,000)</u>	<u>(\$4,945,000)</u>	<u>(\$6,800,000)</u>

Description of fiscal impact: HB 111, as amended, phases-in an exemption of certain military retirement pay from Montana individual income tax. The exemption starts at 10% in tax year (TY) 2021 and reaches its full implementation rate of 50% in TY 2025. General fund revenue is reduced by \$1,883,000 in FY 2022, \$3,167,000 in FY 2023, \$4,945,000 in FY 2024 and \$6,800,000 in FY 2025.

FISCAL ANALYSIS

Assumptions:

Department of Revenue (DOR)

- Under current law, military disability payments are exempt from federal and state taxation, but retirement pay based on length of service and survivor benefits are generally taxable.
- HB 111, as amended, phases-in in 10 percentage point increments a state income tax 50% exemption for military retirement pay and military survivor benefits beginning in tax year TY 2021.
- Based on 1099-R forms provided to DOR by the U.S. Treasury Modernized e-File (MeF) program, there were 6,425 Montana taxpayers identified as receiving retirement income from the U.S. Department of Defense's Defense Finance and Accounting Service who filed electronic TY 2019 full-year resident income tax returns.
- The department only receives digital copies of form 1099-R through the MeF program. However, not all taxpayers file their returns through a MeF electronic filing provider.

5. Based on total taxable retirement income on Montana’s returns and the total taxable income reported on all Montana received MeF 1009-R forms, approximately 90% of all taxable retirement income is filed electronically. It is assumed that 90% of aggregate taxable military retirement income was reported on Montana electronic income tax filings.
6. The 6,425 taxpayers e-filed approximately \$170 million in taxable military retirement income in TY 2019.
7. The Department of Revenue’s income tax model was modified to incorporate the military income exemption changes made by HB 111. The estimated income and tax liability amount under the proposed law were then compared to current law (HJ 2) income and tax liability forecasts.
8. Based on the income amounts reported on the 6,425 1099-R forms and model adjustments, exempting military retirement income in TY 2021 is estimated to reduce the tax liability of full-year resident taxpayers by \$1,093,473. By TY 2024, the tax liability reduction increases to \$5,083,815.

Tax Liability Estimates Under Current Law and HB 111 as Amended (Millions \$)			
Tax Year	Current Law	Proposed Law	Change in Revenue
2021	\$1,350.260	\$1,349.160	(\$1.093)
2022	\$1,395.680	\$1,393.370	(\$2.311)
2023	\$1,454.550	\$1,450.890	(\$3.657)
2024	\$1,521.480	\$1,516.390	(\$5.084)

9. As HB 111 makes large changes to the taxable income of some taxpayers with military retirement income, it is assumed that some of the taxpayers will change their withholding and estimated payments. It is assumed that 80% of TY 2022 tax liability changes and 20% of TY 2023 tax liability changes will occur in FY 2023. It is assumed a similar distribution continues in future fiscal years.
10. For TY 2021 it is assumed that taxpayers will not change their withholding and estimated payment amounts before the end of FY 2021. Because of this, the tax liability reduction for TY 2021 will occur in FY 2022.
11. The change in the estimated tax liabilities of full-year resident taxpayers were adjusted to account for the changes in withholding, estimated payments, non-resident taxpayers, income tax credits and audit collections.
12. The tax liability estimate was increased by 10%, to account for Montana 1099-R forms not filed electronically.
13. Based on the adjustments used for HJ 2, the proposed bill would reduce income tax revenue by \$1.883 million in FY 2022, \$3.167 million in FY 2023, \$4.945 million in FY 2024 and \$6.800 million in FY 2025.
14. The changes made by the proposed bill can be made as part of the department’s annual change process. The department does not expect to incur any significant additional cost because of this bill.

<u>Fiscal Impact:</u>	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>
<u>Department of Revenue</u>	<u>Difference</u>	<u>Difference</u>	<u>Difference</u>	<u>Difference</u>
FTE	0.00	0.00	0.00	0.00
Expenditures:				
Personal Services	\$0	\$0	\$0	\$0
TOTAL Expenditures	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Funding of Expenditures:				
General Fund (01)	\$0	\$0	\$0	\$0
TOTAL Funding of Exp.	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Revenues:				
General Fund (01)	(\$1,883,000)	(\$3,167,000)	(\$4,945,000)	(\$6,800,000)
TOTAL Revenues	<u>(\$1,883,000)</u>	<u>(\$3,167,000)</u>	<u>(\$4,945,000)</u>	<u>(\$6,800,000)</u>
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	(\$1,883,000)	(\$3,167,000)	(\$4,945,000)	(\$6,800,000)

Long-Term Impacts:

- The revenue decrease as a result of this bill will grow until tax year 2025 as the final phase-in of the income exemption occurs, moving from 40% of qualified income to 50%.

Technical Notes:

- The proposed bill includes the new military income exemption in the same subsection as the state’s current partial pension exemption. The inclusion of this exemption in the same subsection makes it unclear as to how the two exemptions interact with each other. Changing the exemption created in HB 111 to a new subsection would help make it clearer as to how these two exemptions apply with each other.

NOT SIGNED BY SPONSOR

_____ 1/20/21 _____ KA _____ 1/19/21
 Sponsor’s Initials Date Budget Director’s Initials Date