GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2023 Biennium

Bill #	SB0399		**Title:**	Generally revise and simplify income taxes
Primary Sponsor:	Hertz, Greg		**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 2022 Difference	FY 2023 Difference	FY 2024 Difference	FY 2025 Difference
Expenditures:				
General Fund	$0	($250,367)	($702,410)	($711,518)
Revenue:				
General Fund	($17,173,000)	($29,416,000)	($31,061,000)	($34,863,000)
Net Impact-General Fund Balance:	($17,173,000)	($29,165,633)	($30,358,590)	($34,151,482)

Description of fiscal impact: SB 399 changes Montana's individual income tax. Montana Taxable Income (MTI) is based on Federal Taxable Income. The number of tax rates is reduced from seven to two. Several individual and corporate income tax credits are eliminated. The changes first apply starting tax year (TY) 2022.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. SB 399 makes changes to Montana's individual income tax, while also making changes that will impact the taxation of estates and trusts, and the state's corporate income tax.
2. Under current law, taxpayers calculate their Montana Taxable Income (MTI) by applying income that is taxed in Montana, but not at the federal level, and by subtracting income from sources that are not taxed by the state. Next, taxpayers subtract either the state's standard deduction or claim itemized deductions. Finally, taxpayers reduce that income by applying their personal income exemption and any exemptions allowed for dependents. Taxpayers are allowed additional exemptions for being at least 65 years old, or if they are blind.
3. Under SB 399, taxpayers MTI is based on their Federal Taxable Income, with additional adjustments. These adjustments include a 30% deduction on net-long term capital gains, the addition of the federal Qualified

Business Income (QBI) deduction, a $5,500 income exemption for taxpayers at least 65 years old, and several other income additions and income subtractions.

4. Under current law, taxpayers with positive MTIs have their income taxed at seven different tax rates, with tax rates ranging between 1% and 6.9%. The same income thresholds apply to all filing types.
5. Under SB 399, taxpayers with taxable income will have their income taxed at two rates, 4.7% and 6.5%. The income thresholds under which taxpayers pay the 6.5% rate changes depending on the taxpayer's filing status.
6. Under SB 399 taxpayers must choose the same filing status as they used when filing their federal income tax.
7. SB 399 eliminates the state's capital gains income tax credit of 2% of capital gains income.
8. The proposed bill also makes several changes to the Montana Education Savings Program. The proposed bill expands the types of expenditures Education Savings Program funds can be used for without having to pay tax on the income from the fund. Taxpayers can spend ESP money on any cost covered in 26 U.S. Code 529. New expenses allowed under the proposed changes include K-12 tuition, certain expenses for registered apprenticeships, and repayment of student loans. Taxpayers are also able to exempt income used for a qualified tuition program.
9. It is assumed that the proposed changes to the state's Montana Education Savings Program will increase the amount of income exempted from Montana's personal income tax by 50%.
10. The changes made by SB 399 apply starting TY 2022.
11. The Department of Revenue's income tax model was modified to include the changes made by the proposed bill. The estimated income tax liability amounts under the proposed law were then compared to current law income and tax liability forecasts.
12. Based on the department's income tax model, the changes made by SB 399 would reduce the income tax liability of full-year resident taxpayers by $32.250 million in TY 2022. For TY 2023, TY 2024, and 2025, the tax liability of residents would decrease by $31.894 million, $34.759 million, and $38.812 million, respectively.

Tax Liability Estimates Under Current Law and SB 399			
	Tax Liability (Millions $)		
Tax Year	Current Law	SB 399	Change
2022	$1,393.283	$1,361.033	($32.250)
2023	$1,452.144	$1,420.251	($31.894)
2024	$1,519.063	$1,484.304	($34.759)
2025	$1,596.083	$1,557.271	($38.812)

13. The change in taxable income and tax rates will require the department to update its withholding tables at the beginning of TY 2022. The changes to withholding tables will result in reduced income tax collections at the start of TY 2022, which is the second half of FY 2022. It is assumed that half the tax liability impact of the proposed law for each tax year will occur in the second half of the current fiscal year and the second half will occur during the first half of the following fiscal year.
14. The tax liability amounts from the proposed tax changes were adjusted based on HJ 2 assumptions for non-full-year resident taxpayers, audit collections, population increases, and other changes.
15. Based on the above, SB 399 is estimated to reduce income tax revenue by $17.173 million in FY 2022, $35.623 million in FY 2023, $37.725 million in FY 2024, and $41.838 million in FY 2025.
16. SB 399 also eliminates several personal and corporate income tax credits and deductions.
17. The revenue impact associated with the elimination of the capital gains tax credit is included in the revenue estimates in the previous section. The remaining income tax credits being eliminated, and credits forecast, is provided in the table below.

Credits Eliminated by SB 399 and their HJ 2 Forecast Amounts (Millions $)				
	Tax Year			
Credits Eliminated	2022	2023	2024	2025
College Contribution Credit	$0.333	$0.342	$0.351	$0.360
Energy Conservation Credit	$3.919	$3.919	$3.919	$3.919
Alternative Fuel Credit	$0.014	$0.014	$0.014	$0.014
Health Insurance for Uninsured MT Credit	$0.075	$0.075	$0.075	$0.075
Elderly Care Credit	$0.083	$0.086	$0.088	$0.090
Dependent Care Credit	$0.025	$0.025	$0.025	$0.025
Recycle Credit	$0.554	$0.554	$0.554	$0.554
Biodiesel Blending and Storage Credit	$0.000	$0.000	$0.000	$0.000
Geothermal Systems Credit	$0.108	$0.108	$0.108	$0.108
Alternative Energy Credit	$0.408	$0.408	$0.408	$0.408
Low-emission wood or biomass credit	$0.194	$0.194	$0.194	$0.194
Alternative Energy Production Credit	$0.064	$0.064	$0.064	$0.064
Mineral / Coal Exploration Credit	$0.001	$0.001	$0.001	$0.001
Emergency Lodging Credit	$0.000	$0.000	$0.000	$0.000
Empowerment Zone Credit	$0.000	$0.000	$0.000	$0.000
Adoption Credit	$0.182	$0.182	$0.182	$0.182
Oil Seed Credit	$0.000	$0.000	$0.000	$0.000
Historical Property Preservation Credit	$0.035	$0.035	$0.034	$0.034
Total	$5.995	$6.006	$6.017	$6.028
Carry-Forward	$0.600	$0.300	$0.000	$0.000
Total Revenue Change	$5.396	$5.706	$6.017	$6.028

18. Some of the taxpayers who claim the credits listed above did not have enough tax liability to use the whole credit. With some of the credits, taxpayers can carry unused credits forward into future tax years to offset future tax liabilities.
19. Based on TY 2019 unused credits, it is assumed that 10% of current law credits that would have been claimed in TY 2022, due to credits carried-forward credit from the previous tax year. For TY 2023, it is assumed that 5% of these credits will continue to be claimed as carryforwards. It is assumed that none of the eliminated credits will be carried-forward into TY 2024 or TY 2025.
20. Based on $5.995 million in credits in TY 2022, and a 10% carryforward rate, $600,000 in income tax credits will be carried forward in TY 2022. For TY 2023, there will be $300,000 in credits carried forward.
21. In total, the elimination of the income tax credits in TY 2022 will increase income tax liabilities by $5.396 million. For TY 2023, TY 2024, and TY 2025, the elimination of the credits will increase income tax liabilities by $5.706 million, $6.017 million, and $6.028 million, respectively.
22. The same credits are eliminated from Montana's corporate income tax. In addition, the corporate deduction for recycled material is also eliminated. In TY 2018, corporations reported approximately $960,000 worth of these eliminated credits and deductions. It is assumed that the same number of credits would have been claimed in future tax years.
23. It is assumed that taxpayers will not change their withholding or estimated payment amounts as a result of the income tax credit changes. With no changes to withholding or estimated payments, the tax liability changes for each tax year will increase income tax revenue the following fiscal year when taxpayers file their returns.
24. Based on corporate and individual income tax credit and deduction usage forecast, the elimination of the credits and deductions will increase tax revenue by $6.354 million in FY 2023, $6.664 million in FY 2024, and $6.975 million in FY 2025.
25. Taxpayers with additions or subtractions need to adjust their federal adjusted gross income under current law. SB 399 allows taxpayers with net adjustments carried-forward from previous years to use the adjustments in TY 2022, but not in later tax years. Taxpayers with adjustments that reduce their taxable income are assumed to adjust their income in TY 2022. Based on TY 2019 income tax returns, qualifying adjustments reduced

Montana Taxable Incomes by $2.250 million. It is assumed taxpayers who use this adjustment option will be in the top tax rate of 6.5%. Based on $2.250 million in taxable income, and a tax rate of 6.5%, the transition adjustment will reduce income tax revenue by $146,240 in TY 2022. It is assumed these taxpayers will not adjust their withholding or estimated payment which will reduce income tax revenue by $146,240 in FY 2023.

26. When combined, the income tax changes, and the tax credit and deduction changes will reduce general fund revenue by $17.173 million in FY 2022. This increases to $29.416 in FY 2023, $31.061 million in FY 2024, and $34.863 million in FY 2025.

Tax Revenue Change by Fiscal Year				
Fiscal Year	Income Tax Changes	Tax Credit and Deduction Changes	Transition Adjustment	Change in Revenue (Millions)
2022	($17.173)	$0.000	$0.000	($17.173)
2023	($35.623)	$6.354	($0.146)	($29.416)
2024	($37.725)	$6.664	$0.000	($31.061)
2025	($41.838)	$6.975	$0.000	($34.863)

DOR Administrative Expenses

27. The department will be required to update and modify its income tax forms, and the integrated revenue information system. The updates can be performed as part of the department's annual update process and will not incur any additional costs.
28. With a shorter and simpler form, the department would be able to reduce the cost of administering the state's personal income tax. The simplification of the income tax reduces the number of tax examiners required by the department to administer and audit income tax returns by 2.00 FTE in FY 2023, with a reduction of 5.00 FTE in FY 2024 and FY 2025. The simplification of the personal income tax form would reduce the number of employees required to process and record the information on returns. The form simplification leads to a 3.00 FTE reduction. The three FTE reduction begins half-way through FY 2023, so the reduction is 1.50 FTE in FY 2023. The department will also reduce the number of attorney positions by 1.00 FTE starting FY 2024. The combined reduction in FTE is 3.5 in FY 2023, which increases to 9.00 FTE by FY 2024. The FTE reduction will reduce department expenditures by $250,367 in FY 2023, $702,410 in FY 2024, and $711,518 in FY 2025.

Department of Revenue Expenditure Change under SB 399				
		Fiscal Year		
	2022	**2023**	**2024**	**2025**
Income Tax and Withholding Tax				
FTE	0.00	(2.00)	(5.00)	(5.00)
Total Personal Services	$0	($141,571)	($358,291)	($362,713)
Annual Operating Expenses	$0	($16,018)	($40,800)	($41,570)
Information Management Collections Division				
FTE	0.00	(1.50)	(3.00)	(3.00)
Total Personal Services	$0	($80,613)	($163,078)	($164,955)
Annual Operating Expenses	$0	($12,165)	($24,480)	($24,942)
Director's Office				
FTE	0.0	0.0	(1.0)	(1.0)
Total Personal Services	$0	$0	($107,601)	($109,024)
Annual Operating Expenses	$0	$0	($8,160)	($8,314)
Total Impact				
FTE	0.00	(3.50)	(9.00)	(9.00)
Total Personal Services	$0	($222,184)	($628,970)	($636,692)
Annual Operating Expenses	$0	($28,183)	($73,440)	($74,826)
Total Cost	$0	($250,367)	($702,410)	($711,518)

Fiscal Impact:	**FY 2022 Difference**	**FY 2023 Difference**	**FY 2024 Difference**	**FY 2025 Difference**
Department of Revenue				
FTE	0.00	(3.50)	(9.00)	(9.00)
Expenditures:				
Personal Services	$0	($222,184)	($628,970)	($636,692)
Operating Expenses	$0	($28,183)	($73,440)	($74,826)
TOTAL Expenditures	$0	($250,367)	($702,410)	($711,518)
Funding of Expenditures:				
General Fund (01)	$0	($250,367)	($702,410)	($711,518)
TOTAL Funding of Exp.	$0	($250,367)	($702,410)	($711,518)
Revenues:				
General Fund (01)	($17,173,000)	($29,416,000)	($31,061,000)	($34,863,000)
TOTAL Revenues	($17,173,000)	($29,416,000)	($31,061,000)	($34,863,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($17,173,000)	($29,165,633)	($30,358,590)	($34,151,482)

Long-Term Impacts:

Department of Revenue

1. SB 399 bases Montana's taxable income on Federal Taxable Income (FTI). The Tax Cuts and Jobs Act of 2017 (TCJA) made significant changes to how FTI is determined. Most of the changes made by TCJA set to expire at the end of TY 2025. If the changes made by the Act do expire after TY 2025, many of the changes will also apply to Montana's income tax. It is unclear how this will impact Montana income tax revenue.

Office of Budget and Program Planning

2. While SB 399 streamlines taxpayer reporting of income tax, it also reduces the sources of detailed information reported on Montana individual income tax returns. The change in Montana detail will require the Legislative Fiscal Division and the Office of Budget and Program Planning to rely on lagged and aggregated federal income tax data DOR extracts from federal tax returns of Montana filers to model tax policy changes and forecast individual income tax revenue. This will likely lead to estimates with marginally wider confidence intervals, particularly in the earliest years of the change in available tax data.

Technical Notes:

Department of Revenue

1. The inflation adjustment factor is based on the previous tax year's June CPI divided by the June CPI in 2022. Based on a baseline year of 2022, there will be no inflation adjustment of the income tax brackets in TY 2023.
2. SB 399 changes the expenditures that qualify for Montana's Family Education Savings Accounts. The changes to the account are similar to the changes proposed in HB 129. However, the changes are not identical.

3. Currently, per Section 9901 of the American Recovery Plan Act (ARPA) which adds New Section 602 to 42 U.S.C. 801, it is unknown if reductions to state taxes resulting in a reduction to net state tax revenue may jeopardize receipt, or require repayment, of State Recovery Funds contained in the ARPA.

NO SPONSOR SIGNATURE	3.31	KA	3-31-21
Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*