



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 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</u> <u>Difference</u> | <u>FY 2023</u> <u>Difference</u> | <u>FY 2024</u> <u>Difference</u> | <u>FY 2025</u> <u>Difference</u> |
|---|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Expenditures: | | | | |
| General Fund | \$0 | (\$147,417) | (\$149,311) | (\$467,751) |
| Revenue: | | | | |
| General Fund | \$0 | \$4,866,000 | (\$10,306,000) | (\$29,949,000) |
| Net Impact-General Fund Balance: | <u>\$0</u> | <u>\$5,013,417</u> | <u>(\$10,156,689)</u> | <u>(\$29,481,249)</u> |

Description of fiscal impact: SB 399, as amended in the House Taxation Committee, changes Montana's individual income tax so that 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. The bill as amended will increase general fund revenue by \$4.866 million in FY 2022 and decrease revenue by \$10.306 million and \$29.949 million in FY 2024 and 2025, respectively.

FISCAL ANALYSIS

Assumptions:

Department of Revenue

1. SB 399 makes changes to Montana's individual income tax, and also makes changes that will impact the taxation of estates and trusts, and the state's corporate income tax.
2. With the amendments to SB 399, the House Taxation Committee changed the tax year in which the income tax changes apply from TY 2022 to TY 2024. The bill also changes the inflation factor to correspond to the new tax year-based level. Except for the capital gains credit, the amendments do not change the applicability date associated with the tax credit changes made by SB 399, which continue to apply starting TY 2022.
3. 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.
4. 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.
 5. 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.
 6. 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.
 7. Under SB 399 taxpayers must choose the same filing status as they used when filing their federal income tax.
 8. SB 399 eliminates the state’s capital gains income tax credit of 2% of capital gains income.
 9. 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.
 10. It is assumed that the proposed changes to the state’s Montana Education Savings Program will increase the amount of income exempted from expenditures for the Program by 50%.
 11. The changes made by SB 399 apply starting TY 2024.
 12. 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.
 13. 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 \$29.075 million in TY 2024. For TY 2025, the tax liability of residents would decrease by \$34.862 million.

| Tax Liability Estimates Under Current Law and SB399 | | | |
|---|--------------------------|--------------|-------------------|
| Tax Year | Tax Liability (Millions) | | |
| | Current Law | Proposed Law | Change in Revenue |
| 2022 | \$1,501.115 | \$1,501.115 | \$0.000 |
| 2023 | \$1,557.292 | \$1,557.292 | \$0.000 |
| 2024 | \$1,631.477 | \$1,602.402 | (\$29.075) |
| 2025 | \$1,715.133 | \$1,680.272 | (\$34.862) |

14. The change in taxable income and tax rates will require the department to update its withholding tables at the beginning of TY 2024. The changes to withholding tables will result in reduced income tax collections at the start of TY 2024, which is the second half of FY 2024. 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.
15. The tax liability amounts from the proposed tax changes were adjusted based on HJ 2 as amended. The assumptions address adjustments for non-full-year resident taxpayers, audit collections, population increases, and other changes.
16. Based on a 50/50 distribution of the tax liability change across fiscal years, and the adjustments used for HJ 2, the proposed bill will reduce income tax revenue by \$15.453 million in FY 2024, and \$35.232 million in FY 2025.
17. As amended, SB 399 eliminates several personal and corporate income tax credits and deductions starting in TY 2022.

18. 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.

| HJ 2 Forecast Amounts of Credits Eliminated by SB 399 as Amended (Millions \$) | | | | |
|---|----------------|----------------|----------------|----------------|
| Credits Eliminated | Tax Year | | | |
| | 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 |
| 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 |
| Total | \$5.406 | \$5.418 | \$5.429 | \$5.441 |
| Carry-Forward | \$0.541 | \$0.271 | \$0.000 | \$0.000 |
| Total Revenue Change | \$4.866 | \$5.147 | \$5.429 | \$5.441 |

19. Some taxpayers who claim credits listed above will not have enough tax liability to use the full credit. Credits which can be carried-over into subsequent tax years will be used to offset future tax liabilities.
20. 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.
21. Based on \$5.046 million in credits in TY 2022, and a 10% carryforward rate, \$541,000 in income tax credits will be carried forward in TY 2022. For TY 2023, there will be \$271,000 in credits carried forward.
22. In total, the elimination of the income tax credits in TY 2022 will increase income tax liabilities by \$4.866 million. For TY 2023, TY 2024, and TY 2025, the elimination of the credits will increase income tax liabilities by \$5.147 million, \$5.429 million, and \$5.441 million, respectively.
23. The same credits are eliminated from Montana’s corporate income tax. In TY 2018, corporations reported approximately \$3,000 worth of these eliminated credits and deductions. It is assumed that the same number of credits would have been claimed in future tax years.
24. 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.
25. Based on corporate and individual income tax credit and deduction usage forecast, the elimination of the credits and deductions will increase tax revenue by \$4.869 million in FY 2023, \$5.150 million in FY 2024, and \$5.432 million in FY 2025.
26. 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 2024, but not in later tax years. Taxpayers with adjustments that reduce their taxable income are assumed to adjust their income in TY 2024. 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 2024. It is assumed these taxpayers will not adjust their withholding or estimated payment which will reduce income tax revenue by \$146,240 in FY 2025.

27. When combined, the income tax changes, and the tax credit and deduction changes will increase general fund revenue by \$4.866 million in FY 2023. This changes to a \$10.306 million decrease in FY 2024 and \$29.949 million decrease 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 | \$0.000 | \$0.000 | \$0.000 | \$0.000 |
| 2023 | \$0.000 | \$4.866 | \$0.000 | \$4.866 |
| 2024 | (\$15.453) | \$5.147 | \$0.000 | (\$10.306) |
| 2025 | (\$35.232) | \$5.429 | (\$0.146) | (\$29.949) |

DOR Administrative Expenses

28. 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.

29. With a shorter and simpler form, the Department of Revenue 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 and auditors required by the department to administer and audit income tax returns by 2.00 FTE in FY 2023 and 2024, with a reduction of 5.00 FTE in 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 reduces the number of FTE required by three. The three FTE reduction begins half-way through FY 2025, so there is only a 1.5 FTE reduction for this fiscal year. The combined reduction in FTE is 2.00 in FY 2023 and FY 2024, which increases to five by FY 2025. The FTE reduction will reduce department expenditures by \$147,417 in FY 2023, \$149,311 in FY 2024, and \$467,947 in FY 2025.

| Department of Revenue Expenditure Change under SB 399 | | | | |
|---|-------------|--------------------|--------------------|--------------------|
| | Fiscal Year | | | |
| | 2022 | 2023 | 2024 | 2025 |
| Income Tax and Withholding Tax | | | | |
| FTE | 0.0 | (2.0) | (2.0) | (5.0) |
| Total Personal Services | \$0 | (\$131,399) | (\$132,991) | (\$331,274) |
| Annual Operating Expenses | \$0 | (\$16,018) | (\$16,320) | (\$41,570) |
| Information Management Collections Division | | | | |
| FTE | 0.0 | 0.0 | 0.0 | (1.5) |
| Total Personal Services | \$0 | \$0 | \$0 | (\$82,477) |
| Annual Operating Expenses | \$0 | \$0 | \$0 | (\$12,626) |
| Total Impact | | | | |
| FTE | 0.0 | (2.0) | (2.0) | (6.5) |
| Total Personal Services | \$0 | (\$131,399) | (\$132,991) | (\$413,751) |
| Annual Operating Expenses | \$0 | (\$16,018) | (\$16,320) | (\$54,196) |
| Total Cost | \$0 | (\$147,417) | (\$149,311) | (\$467,947) |

| Fiscal Impact: | FY 2022 | FY 2023 | FY 2024 | FY 2025 |
|---|--------------------------|--------------------------|--------------------------|--------------------------|
| Department of Revenue | <u>Difference</u> | <u>Difference</u> | <u>Difference</u> | <u>Difference</u> |
| FTE | 0.00 | (2.00) | (2.00) | (5.00) |
| <u>Expenditures:</u> | | | | |
| Personal Services | \$0 | (\$131,399) | (\$132,991) | (\$413,751) |
| Operating Expenses | \$0 | (\$16,018) | (\$16,320) | (\$54,196) |
| TOTAL Expenditures | \$0 | (\$147,417) | (\$149,311) | (\$467,947) |
| <u>Funding of Expenditures:</u> | | | | |
| General Fund (01) | \$0 | (\$147,417) | (\$149,311) | (\$467,947) |
| TOTAL Funding of Exp. | \$0 | (\$147,417) | (\$149,311) | (\$467,947) |
| <u>Revenues:</u> | | | | |
| General Fund (01) | \$0 | \$4,866,000 | (\$10,306,000) | (\$29,949,000) |
| TOTAL Revenues | \$0 | \$4,866,000 | (\$10,306,000) | (\$29,949,000) |
| <u>Net Impact to Fund Balance (Revenue minus Funding of Expenditures):</u> | | | | |
| General Fund (01) | \$0 | \$5,013,417 | (\$10,156,689) | (\$29,481,053) |

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 are 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. This fiscal note does not contemplate how this may 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 DOR for aggregated (and lagged) federal income tax data extracts 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. This fiscal note was prepared using the present law income tax assumptions in the HJ 2 revenue estimates as approved by the House Taxation committee on March 29, 2021.
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.

SPONSOR SIGNATURE

Sponsor’s Initials _____
Date *KA* _____
Budget Director’s Initials *4-22-21* _____
Date