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Memorandum

To: Representative Jeff Essmann
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From: Aaron McNay, Tax Policy and Research

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Subject: Revenue Impact of Statewide and Local Option Sales Taxes

The taxation of the sales of goods and some services is a standard method of collecting tax revenue at the local, state and national level. As of 2015, 45 states within the United States collect sales taxes, with tax rates that range between 2.9 percent and 7.5 percent. In addition to the statewide sales tax, 38 states also allow the collection of local sales taxes. Montana is currently one of five states with no general statewide tax. In an effort to estimate the revenue impacts that the implementation a statewide sales tax would have in the state, the Department of Revenue currently maintains a sales tax model, which provides revenue estimates based on statewide sales, spending and demographic data. The purpose of this memorandum is to provide information on the general structure of sales taxes, Montana's sales tax model, and revenue estimates based on several sales tax structures at the statewide and local level.

Sales Tax Information

The State of Montana currently generates revenue from several different sources, with transfers from the federal government and state level taxes comprising more than 80 percent of tax revenue. Montana's largest sources of tax revenue are income and property taxes, which comprise approximately 65 percent of state and local tax revenue. Unlike other states, sales and excise taxes comprise a relatively small portion of state and local tax revenue in Montana, at approximately 10 percent of total revenue. For comparison, sales and excise taxes comprise approximately 50 percent of South Dakota's state and local tax revenue. For Wyoming, Idaho and North Dakota, sales and excise taxes comprise approximately 31 percent, 30 percent and 24 percent of total tax revenue respectively. The cause of Montana's relatively low share of sales and excise tax revenue is primarily the lack of a general statewide sales tax.

Conventional sales taxes are levied on the sale of goods and services to the final end user, or consumer. The amount of taxes that are due are based on a percentage of the prices of the goods, or services, which were sold. For example, a consumer purchasing a \$50 appliance from a retail store would pay \$2 in taxes under a 4 percent sales tax. Unlike other consumption taxes, such as a value added tax, the sale of goods and services to a business to be resold later to a final consumer are generally not subject to sales taxes.

The amount of revenue generated by a sales tax is dependent on two main factors, the tax rate as well as the types of goods and services subject to the tax. In the United States, statewide sales taxes range between 2.9 percent in Colorado to 7.5 percent in California. Montana's surrounding states have sales tax rates of 4 percent in Wyoming and South Dakota, 5 percent in North Dakota and 6 percent in Idaho. Local sales taxes can increase the sales tax rates of some areas above their statewide level, with combined rates that can exceed 10 percent. Montana's tax rate for a statewide sales tax is limited to 4 percent in the state constitution.

The actual types of goods and services covered by sales taxes vary significantly across states. The sale of non-essential tangible personal property is subject to the tax in most sales tax systems. However, the sale of essential items, like non-prepared food and prescription drugs, are usually exempted from sales taxes. Most sales tax systems tax at least some services provided by businesses. However, a majority of services purchased by consumers are not subject to sales taxes in most sales tax systems. Overall, the types of goods and services subject to a sales tax has a significant impact on the amount of revenue that is generated by the tax.

A Review of Montana's Sales Tax Model

In an effort to generate sales tax revenue estimates, the Department of Revenue developed a sales tax revenue estimation model based on data from the U.S. Census Bureau's Economic Census of Businesses, the U.S. Department of Labor's Consumer Expenditure Survey and the Montana Department of Commerce's population projections. Based on industry data, the sales tax model can project revenue for sales taxes that exclude particular industries or services, such as food sales or medical services. The sales tax model can also project future sales tax revenue based on forecasted consumer spending patterns and population levels. Finally, the sales tax model provides revenue estimates based on various sales tax rates that are proposed in legislation.

To generate its revenue estimates, the department's sales tax model follows a four step process. In the first step, historical total sales data from the 2012 Economic Census of Businesses is used to provide taxable sales estimates for each of Montana's economic sectors, such as retail sales, construction services and accommodation and food services. As a sales tax does not tax intermediate sales, taxable sales excludes the sale of goods from one business to another. Next, the historical sales data is projected forward using changes to consumer spending patterns, based on the Consumer Expenditure Survey. For the third step, projected sales data is adjusted based on projected changes to Montana's

population. Finally, the specified tax rate, non-compliance and vendor allowance rates are applied to the adjusted taxable sales to provide the final revenue estimate.

In the end, the revenue amounts provided by the revenue model are estimates, and are subject to several assumptions and limitations. One the primary assumptions made by the model is that consumption spending by residents of Montana are similar to the spending patterns of the United States as a whole. This assumption is due to the lack of state level consumer spending pattern data. Another assumption is that industry sales do not change significantly over a short amount of time. This assumption is necessary, as industry sales data from the Economic Census are only released every five years and must be projected forward.

Statewide Sales Tax Revenue Estimates

The types of goods and services that are covered under a sales tax has a significant impact on the amount of revenue that a sales tax generates. For example, a sales tax of 4 percent that covered every single end-user good and service in Montana would have the potential to generate \$1.7 billion in fiscal year 2017, according to the department's revenue model. However, no state applies their sales tax to the sale of all end-use goods and services. As a result, the \$1.7 billion revenue estimate is the theoretical maximum amount of revenue a sales tax could possibly achieve in Montana.

Sales taxes is most other states tax the sale of most end-user goods, with the sale of essential items, such as food or medicine, excluded from the sales tax. At the same time, some services are taxed, such as foods sales at restaurants, while most services are not covered under the sales tax. Limiting the types of goods and services covered by Montana's sales tax to those covered by sales taxes in other states would reduce the total amount of revenue generated by a 4 percent sales tax to approximately \$613 million in FY 2017. FY 2018 and industry revenue estimates are also available for this sales tax coverage level in the Representative columns in the table below.

Statewide Sales Tax Revenue Estimates						
Industry	Goods and Services Covered By Sales Tax					
	Representative		Expansive		Theoretical Maximum	
	FY 2017	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018
Logging, fishing & hunting, ag support	\$0	\$0	\$0	\$0	\$89,177,997	\$90,125,934
Mining	\$0	\$0	\$0	\$0	\$229,785,163	\$231,754,564
Utilities	\$0	\$0	\$0	\$0	\$21,683,960	\$21,707,853
Construction	\$0	\$0	\$70,695,531	\$71,301,436	\$151,703,413	\$153,003,605
Manufacturing	\$0	\$0	\$0	\$0	\$23,489,301	\$23,688,337
Wholesale Trade	\$24,259,444	\$24,469,660	\$24,259,444	\$24,469,660	\$29,297,665	\$29,538,548
Retail Trade	\$479,613,130	\$481,912,716	\$479,613,130	\$481,912,716	\$557,465,130	\$561,059,599
Transportation & Warehousing	\$306,069	\$309,641	\$7,337,592	\$7,423,220	\$65,607,716	\$66,373,339
Information	\$1,086,312	\$1,065,384	\$1,086,312	\$1,065,384	\$29,700,151	\$29,443,756
Finance & Insurance	\$0	\$0	\$0	\$0	\$52,374,888	\$52,713,322
Real Estate & Rental & Leasing	\$7,120,151	\$7,204,847	\$8,882,813	\$8,959,358	\$49,804,561	\$51,205,174
Professional, Scientific, & Technical Services	\$0	\$0	\$18,609,315	\$18,768,808	\$18,609,315	\$18,768,808
Administrative & Support & Waste Management & Remediation Services	\$1,128,724	\$1,138,398	\$14,289,951	\$14,412,425	\$14,289,951	\$14,412,425
Educational Services	\$0	\$0	\$0	\$0	\$4,245,288	\$4,281,672
Health Care & Social Assistance	\$0	\$0	\$0	\$0	\$265,904,737	\$271,049,732
Arts, Entertainment, & Recreation	\$13,555,747	\$13,550,695	\$14,467,101	\$14,461,709	\$14,467,101	\$14,461,709
Accommodations & Foodservices	\$69,100,166	\$69,115,341	\$69,100,166	\$69,115,341	\$69,100,166	\$69,115,341
Other Services (except public administration)	\$25,153,708	\$25,552,514	\$25,153,708	\$25,552,514	\$26,801,640	\$27,174,726
Total Sales Tax Revenue	\$621,323,451	\$624,319,197	\$733,495,063	\$737,442,572	\$1,713,508,142	\$1,729,878,446
Vendor Allowance (\$50 per Vendor)	\$7,984,628	\$7,996,237	\$8,419,293	\$8,434,590	\$12,216,844	\$12,280,279
Net Sales Tax Revenue After Vendor Allowance	\$613,338,823	\$616,322,960	\$725,075,770	\$729,007,982	\$1,701,291,298	\$1,717,598,167
Estimated Sales Taxes Paid By Montana Residents	\$583,948,374	\$586,789,515	\$690,331,023	\$694,074,808	\$1,619,767,493	\$1,635,292,957

Recently, the sale of services to consumers has been a growing share of economic activity. As a result, some have suggested that the types of services covered by a sales tax should be expanded to include areas such as construction and professional services. Expanding the types of services covered under Montana's sales tax to include a broader range of consumer services increases the amount of revenue that would be generated by the tax in FY 2017 to approximately \$725 million (Expansive estimates in the previous table).¹

One of the advantages of a sales tax is that non-resident visitors of the state who purchase goods and services also pay the tax, which reduces the amount of taxes that are paid by residents of the state. In 2015, the Institute for Tourism and Recreation Research at the University of Montana² estimated that non-resident travelers to Montana spent approximately \$3.9 billion in Montana during 2014. The department's revenue model estimates that total sales in Montana were \$81.4 billion in FY 2014, resulting in non-resident spending comprising approximately 4.8 percent of total sales in the state. Assuming the proportion of spending remains unchanged between FY 2014 and FY 2017, non-resident travelers could pay between \$29.4 million and \$81.5 million in sales taxes for FY 2017.

Local Option Sales Tax Revenue Estimates

The department's sales tax model estimates are based on statewide industry sales data, which limits the model to generating statewide revenue estimates. Sub-state estimates cannot be generated using the same model, as complete industry level sales data are not available for most non-state level areas. Local area sales tax revenue for a local-option sales tax can be generated, however, by prorating statewide sales tax revenue by the local area's share of total statewide sales.

When broken down by county, a sales tax in Yellowstone County would generate the largest amount of revenue. For FY 2017, a sales tax that covered most end-user goods and services in Yellowstone County would generate approximately \$205 million in tax revenue. A 4 percent sales tax in Missoula, Flathead and Gallatin County would also generate a significant amount of tax revenue in FY 2017, at \$84.8 million, \$59.9 million and \$59.6 million respectively. Reducing the number of services covered to those covered by most other sales taxes would also reduce the revenue generated to \$173 million for Yellowstone County, \$69.2 million in Missoula County and \$50.7 million in Flathead County.

Four counties in Montana had sales levels so low that the Economic Census cannot provide sales data for the counties. As a result, the sales tax revenue for the four counties is likely to be very low as well. The four counties without sales data include Carter, Golden Valley, Petroleum, and Wheatland counties. Other counties that would generate small amounts of sales tax revenue in FY 2017 are Treasure County (\$60,200), Garfield County

¹ A complete list of the taxable industries selected for each sales tax estimate are available from the Department of Revenue.

² "2014 Nonresident Visitation, Expenditures and Economic Impact Estimates," Kara Grau, Institute for Tourism and Recreation Research, University of Montana, May 2015

(\$72,800), and Wibaux County (\$151,379). In total, 13 counties would generate less than \$1 million in tax revenue if a sales tax on most goods and services were in place during FY 2017.

County Sales Tax Revenue Estimates							
County	Share of Statewide Sales	Goods and Services Covered By Sales Tax					
		Representative		Expansive		Theoretical Maximum	
		FY 2017	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018
Beaverhead County	0.47%	\$2,874,578	\$2,888,564	\$3,398,263	\$3,416,693	\$7,973,561	\$8,049,987
Big Horn County	0.72%	\$4,439,583	\$4,461,183	\$5,248,378	\$5,276,841	\$12,314,603	\$12,432,638
Blaine County	0.48%	\$2,928,873	\$2,943,123	\$3,462,449	\$3,481,227	\$8,124,165	\$8,202,035
Broadwater County	0.31%	\$1,889,554	\$1,898,747	\$2,233,789	\$2,245,904	\$5,241,282	\$5,291,519
Carbon County	0.59%	\$3,642,221	\$3,659,941	\$4,305,754	\$4,329,104	\$10,102,863	\$10,199,699
Carter County	0.00%	\$0	\$0	\$0	\$0	\$0	\$0
Cascade County	8.15%	\$50,012,755	\$50,256,087	\$59,123,987	\$59,444,627	\$138,726,364	\$140,056,056
Chouteau County	0.47%	\$2,891,917	\$2,905,987	\$3,418,761	\$3,437,302	\$8,021,656	\$8,098,544
Custer County	0.92%	\$5,654,237	\$5,681,747	\$6,684,315	\$6,720,566	\$15,683,834	\$15,834,163
Daniels County	0.20%	\$1,197,773	\$1,203,601	\$1,415,981	\$1,423,660	\$3,322,407	\$3,354,252
Dawson County	0.96%	\$5,861,468	\$5,889,986	\$6,929,300	\$6,966,878	\$16,258,655	\$16,414,495
Deer Lodge County	0.40%	\$2,436,652	\$2,448,507	\$2,880,557	\$2,896,179	\$6,758,834	\$6,823,617
Fallon County	0.55%	\$3,394,226	\$3,410,740	\$4,012,579	\$4,034,340	\$9,414,970	\$9,505,212
Fergus County	1.73%	\$10,627,473	\$10,679,180	\$12,563,566	\$12,631,701	\$29,478,693	\$29,761,246
Flathead County	8.27%	\$50,700,292	\$50,946,969	\$59,936,779	\$60,261,826	\$140,633,468	\$141,981,439
Gallatin County	8.22%	\$50,428,142	\$50,673,495	\$59,615,049	\$59,938,352	\$139,878,573	\$141,219,308
Garfield County	0.01%	\$61,585	\$61,885	\$72,804	\$73,199	\$170,825	\$172,463
Glacier County	0.65%	\$3,983,945	\$4,003,329	\$4,709,733	\$4,735,275	\$11,050,745	\$11,156,667
Golden Valley County	0.00%	\$0	\$0	\$0	\$0	\$0	\$0
Granite County	0.11%	\$674,061	\$677,340	\$796,860	\$801,181	\$1,869,723	\$1,887,644
Hill County	1.34%	\$8,219,359	\$8,259,350	\$9,716,747	\$9,769,443	\$22,799,020	\$23,017,549
Jefferson County	0.86%	\$5,247,687	\$5,273,219	\$6,203,700	\$6,237,344	\$14,556,136	\$14,695,657
Judith Basin County	0.03%	\$192,806	\$193,744	\$227,932	\$229,168	\$534,810	\$539,936
Lake County	1.10%	\$6,760,907	\$6,793,802	\$7,992,597	\$8,035,942	\$18,753,538	\$18,933,290
Lewis and Clark County	5.57%	\$34,153,590	\$34,319,761	\$40,375,629	\$40,594,593	\$94,735,901	\$95,643,944
Liberty County	0.09%	\$562,712	\$565,450	\$665,226	\$668,834	\$1,560,862	\$1,575,823
Lincoln County	0.69%	\$4,253,989	\$4,274,686	\$5,028,973	\$5,056,246	\$11,799,799	\$11,912,900
McCone County	0.30%	\$1,835,702	\$1,844,634	\$2,170,127	\$2,181,896	\$5,091,907	\$5,140,712
Madison County	0.46%	\$2,832,322	\$2,846,102	\$3,348,309	\$3,366,467	\$7,856,350	\$7,931,653
Meagher County	0.03%	\$155,470	\$156,226	\$183,793	\$184,790	\$431,246	\$435,379
Mineral County	0.14%	\$868,740	\$872,967	\$1,027,006	\$1,032,575	\$2,409,728	\$2,432,826
Missoula County	11.28%	\$69,202,322	\$69,539,019	\$81,809,475	\$82,253,142	\$191,954,763	\$193,794,648
Musselshell County	0.46%	\$2,847,469	\$2,861,323	\$3,366,216	\$3,384,472	\$7,898,366	\$7,974,072
Park County	0.86%	\$5,283,103	\$5,308,808	\$6,245,569	\$6,279,440	\$14,654,376	\$14,794,838
Petroleum County	0.00%	\$0	\$0	\$0	\$0	\$0	\$0
Phillips County	0.24%	\$1,454,706	\$1,461,784	\$1,719,721	\$1,729,048	\$4,035,092	\$4,073,768
Pondera County	0.54%	\$3,316,864	\$3,333,001	\$3,921,124	\$3,942,389	\$9,200,382	\$9,288,567
Powder River County	0.04%	\$250,653	\$251,872	\$296,316	\$297,923	\$695,266	\$701,930
Powell County	0.27%	\$1,675,608	\$1,683,760	\$1,980,867	\$1,991,610	\$4,647,834	\$4,692,383
Prairie County	0.02%	\$129,014	\$129,642	\$152,518	\$153,345	\$357,862	\$361,292
Ravalli County	1.79%	\$10,962,685	\$11,016,022	\$12,959,846	\$13,030,130	\$30,408,510	\$30,699,975
Richland County	2.58%	\$15,841,375	\$15,918,449	\$18,727,327	\$18,828,889	\$43,941,117	\$44,362,292
Roosevelt County	0.97%	\$5,956,674	\$5,985,656	\$7,041,850	\$7,080,040	\$16,522,741	\$16,681,111
Rosebud County	0.91%	\$5,563,313	\$5,590,381	\$6,576,827	\$6,612,494	\$15,431,627	\$15,579,539
Sanders County	0.73%	\$4,461,881	\$4,483,590	\$5,274,738	\$5,303,344	\$12,376,453	\$12,495,081
Sheridan County	0.42%	\$2,606,065	\$2,618,744	\$3,080,833	\$3,097,541	\$7,228,754	\$7,298,042
Silver Bow County	3.18%	\$19,494,103	\$19,588,949	\$23,045,503	\$23,170,483	\$54,073,126	\$54,591,417
Stillwater County	1.68%	\$10,292,766	\$10,342,845	\$12,167,884	\$12,233,872	\$28,550,278	\$28,823,932
Sweet Grass County	0.27%	\$1,638,194	\$1,646,164	\$1,936,637	\$1,947,140	\$4,544,054	\$4,587,609
Teton County	0.47%	\$2,887,075	\$2,901,122	\$3,413,037	\$3,431,547	\$8,008,226	\$8,084,985
Toole County	0.59%	\$3,638,272	\$3,655,974	\$4,301,086	\$4,324,412	\$10,091,912	\$10,188,642
Treasure County	0.01%	\$50,906	\$51,154	\$60,180	\$60,507	\$141,205	\$142,558
Valley County	0.62%	\$3,799,556	\$3,818,042	\$4,491,752	\$4,516,111	\$10,539,283	\$10,640,301
Wheatland County	0.00%	\$0	\$0	\$0	\$0	\$0	\$0
Wibaux County	0.02%	\$128,051	\$128,674	\$151,379	\$152,200	\$355,189	\$358,594
Yellowstone County	28.22%	\$173,075,550	\$173,917,632	\$204,606,138	\$205,715,753	\$480,080,368	\$484,681,936

The Census of Economic Activities also has sales data for several of Montana's cities. Prorating statewide sales data indicates that a city level local-option sales tax could generate a significant amount of revenue in several of Montana's cities.

A local-option sales tax in the city of Billings would generate the largest amount of tax revenue in the state. For FY 2017, a sales tax that covers most goods and services would generate approximately \$165.3 million in sales tax revenue for the year. A similar sales tax in Missoula and Great Falls would also generate a significant amount of tax revenue, \$67.4 million and \$54.2 million respectively. The decline in revenue rankings of Bozeman and Kalispell relative to those cities' county ranking is the likely result of a large amount of economic activity occurring inside the two counties, but outside the cities. Reducing the number of services covered by the sales tax would reduce the amount of revenue generated within the three cities to \$139.9 million in Billings, \$57 million in Missoula and \$45.8 million in Great Falls.

City Sales Tax Revenue Estimates							
Place	Share of Statewide Sales	Goods and Services Covered By Sales Tax					
		Representative		Expansive		Maximum	
		FY 2017	FY 2018	FY 2017	FY 2018	FY 2017	FY 2018
Belgrade	0.81%	\$4,974,227	\$4,998,429	\$5,880,423	\$5,912,313	\$13,797,609	\$13,929,859
Billings	22.81%	\$139,881,612	\$140,562,192	\$165,364,989	\$166,261,792	\$388,006,368	\$391,725,407
Bozeman	4.88%	\$29,920,127	\$30,065,700	\$35,370,921	\$35,562,744	\$82,993,037	\$83,788,525
Butte-Silver Bow	3.18%	\$19,509,666	\$19,604,588	\$23,063,901	\$23,188,981	\$54,116,295	\$54,635,000
Columbia Falls	0.43%	\$2,654,309	\$2,667,223	\$3,137,866	\$3,154,883	\$7,362,574	\$7,433,144
Conrad	0.34%	\$2,108,042	\$2,118,298	\$2,492,081	\$2,505,596	\$5,847,327	\$5,903,374
Cut Bank	0.43%	\$2,656,580	\$2,669,505	\$3,140,551	\$3,157,583	\$7,368,874	\$7,439,505
Deer Lodge	0.10%	\$630,855	\$633,924	\$745,782	\$749,827	\$1,749,877	\$1,766,649
Dillon	0.28%	\$1,692,230	\$1,700,463	\$2,000,517	\$2,011,366	\$4,693,940	\$4,738,931
Glasgow	0.40%	\$2,437,991	\$2,449,853	\$2,882,139	\$2,897,770	\$6,762,547	\$6,827,366
Glendive	0.39%	\$2,370,274	\$2,381,806	\$2,802,086	\$2,817,283	\$6,574,713	\$6,637,732
Great Falls	7.47%	\$45,816,882	\$46,039,799	\$54,163,717	\$54,457,457	\$127,087,768	\$128,305,904
Hamilton	0.72%	\$4,409,448	\$4,430,902	\$5,212,753	\$5,241,023	\$12,231,014	\$12,348,248
Hardin	0.21%	\$1,287,618	\$1,293,883	\$1,522,194	\$1,530,449	\$3,571,620	\$3,605,854
Havre	0.82%	\$5,043,243	\$5,067,780	\$5,962,011	\$5,994,345	\$13,989,046	\$14,123,131
Helena	4.60%	\$28,188,182	\$28,325,329	\$33,323,454	\$33,504,172	\$78,188,934	\$78,938,375
Kalispell	4.34%	\$26,642,516	\$26,772,143	\$31,496,201	\$31,667,010	\$73,901,536	\$74,609,881
Laurel	0.38%	\$2,319,856	\$2,331,143	\$2,742,483	\$2,757,356	\$6,434,863	\$6,496,541
Lewistown	1.39%	\$8,498,631	\$8,539,980	\$10,046,896	\$10,101,382	\$23,573,669	\$23,799,623
Libby	0.28%	\$1,709,793	\$1,718,111	\$2,021,280	\$2,032,241	\$4,742,657	\$4,788,115
Livingston	0.53%	\$3,223,685	\$3,239,369	\$3,810,970	\$3,831,637	\$8,941,920	\$9,027,629
Miles	0.89%	\$5,477,629	\$5,504,280	\$6,475,533	\$6,510,651	\$15,193,955	\$15,339,589
Missoula	9.29%	\$56,993,304	\$57,270,599	\$67,376,239	\$67,741,633	\$158,089,147	\$159,604,431
Polson	0.33%	\$2,029,132	\$2,039,005	\$2,398,796	\$2,411,805	\$5,628,447	\$5,682,396
Shelby	0.37%	\$2,252,295	\$2,263,253	\$2,662,614	\$2,677,054	\$6,247,461	\$6,307,343
Sidney	1.95%	\$11,956,749	\$12,014,923	\$14,135,008	\$14,211,664	\$33,165,866	\$33,483,761
Whitefish	0.76%	\$4,640,630	\$4,663,209	\$5,486,052	\$5,515,804	\$12,872,271	\$12,995,652
Wolf Point	0.80%	\$4,913,589	\$4,937,495	\$5,808,737	\$5,840,239	\$13,629,409	\$13,760,047