

PROPOSED STUDY PLAN FOR AN INTERIM STUDY OF THE INDIVIDUAL INCOME TAX AND OPTIONS FOR REVISION

Prepared for the Revenue and Transportation Interim Committee
by

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Introduction and Background

House Joint Resolution No. 13 requires an interim study of and options for revising the individual income tax system. The study ranked first of the 16 polled studies.

The individual income tax is the largest source of state revenue, accounting for \$717.8 million in fiscal year 2010. The tax was first imposed in Montana in 1933. Over the years, the tax rates and income tax brackets have changed a number of times. Tax rates are indexed for inflation and, for tax year 2012, ranged from 1% on the first \$2,600 of taxable income to 6.9% on taxable income in excess of \$15,600.

An individual's Montana income tax liability is calculated by adjusting total income by federal and Montana adjustments, subtracting itemized deductions or the standard deduction, and subtracting the personal exemption to arrive at Montana taxable income. Montana taxable income is then multiplied by the tax rate table. This amount is reduced by the 2% capital gains credit and other Montana tax credits to reach the Montana individual income tax liability.

There were 32 bills to change the individual income tax introduced during the 62nd session of the Montana Legislature, but only four of the bills passed the Legislature and were signed by the Governor. With the exception of SB 11, these bills dealt with administration and enforcement of the individual income tax:

- HB 641 requires the Department of Revenue to report certain tax expenditures in the biennial report;
- SB 11 reduces the withholding tax rate on proceeds from lottery winnings;
- SB 166 allows a taxpayer with an individual income tax liability for the current year of \$200 or less to pay the amount due without penalty or interest when filing an extended return;
- SB 413 clarifies the due date of individual income tax returns when the due date of the return falls on a federal holiday or during federally declared disasters not observed in Montana.

In addition, a mail poll to override the Governor's veto of SB 199 is in progress, with results due on June 21, 2011. That bill would revise provisions related to the administration of individual income taxes, specifically penalties on delinquent individual income taxes.

Directions from the Legislature

The resolution directs the Committee to:

- review the provisions of Montana's individual income tax laws, including but not limited to:
 - ▶ general provisions;
 - ▶ conformity with federal income tax law;
 - ▶ provisions related to married filing jointly and married filing separately; and
 - ▶ Montana-specific deductions, exclusions, exemptions, credits, and other special tax provisions;
- conduct an analysis that evaluates the individual income tax in terms of obligation or incidence;
- conduct an analysis of Montana-specific deductions, exclusions, exemptions, credits, and other special tax provisions to determine:
 - ▶ whether the deductions, exclusions, exemptions, credits, and special income tax provisions are meeting their intended purposes;
 - ▶ the costs of the deductions, exclusions, exemptions, credits, and special income tax provisions;
- analyze compliance and administrative costs associated with the state individual income tax, including but not limited to:
 - ▶ taxpayer compliance costs; and
 - ▶ auditing and enforcement costs;
- assess the complexity of the state's individual income tax structure;
- consider options to simplify the state's individual income tax structure, including but not limited to options related to:
 - ▶ conformity with federal income tax laws;
 - ▶ the individual income tax base;
 - ▶ the reduction or elimination of deductions, exclusions, exemptions, credits, and other special tax provisions;
 - ▶ revising Montana's individual income tax rate structure;
 - ▶ the filing provisions for married taxpayers;
- evaluate the advantages and disadvantages of revising the state's individual income tax structure according to the criteria described above.

Study Design

With two other significant interim studies assigned to the Revenue and Transportation Committee (the SJR 17 study on valuing centrally assessed property for tax purpose and the SJR 23 study of the tax treatment of nonprofits), the Committee should consider how to focus Committee and staff efforts and how much time to devote to the HJR 13 study. Recent work by the Revenue and Transportation Interim Committee addressed two areas of interest included in the HJR 13 resolution:

- the filing status of married taxpayers, SJR 37 (2009-2010); and
- the linkage of state and federal income taxes, HJR 61 (2007-2008).

- special income tax provisions are meeting their intended purposes.
- Assessment of the complexity of the individual income tax structure.
- Consideration of options to simplify the individual income tax, including options related to conformity with federal tax laws, the individual income tax base, reduction or elimination of deductions, exclusions, exemptions, credits, and other special tax provisions, revision of the tax rate structure, and provisions related to married taxpayers.

Phase III: Evaluating options

The Committee will now evaluate the options considered in Phase II within the context of the information gathered in Phase I. The resolution directs the Committee to evaluate the advantages and disadvantages of revising the individual income tax structure using the criteria of tax incidence.

The Committee will develop findings and conclusions in this phase.

Phase IV: Legislative options and Committee recommendations

The findings and conclusions developed in Phase III may lead the Committee to develop options for legislative consideration, including draft legislation.

If the Committee determines that no action should be taken at this time, it should consider making a clear statement to that effect and supporting the statement with findings and conclusions developed as a result of the study.

Proposed Committee Meeting Schedule and Work Plan

HJR 13 requires the study to be completed by September 15, 2012. The proposed Committee schedule includes eight meetings. With the first meeting composed largely of organizational matters and the final meeting in November 2012 devoted to the revenue estimating resolution, the Committee will have six meetings to complete the HJR 13 study. All meetings except the final meeting are scheduled as two-day meetings and the Committee should anticipate spending about one-quarter of one day during each two-day meeting on the HJR 13 study.

The following is a proposed schedule for conducting the study:

September 15-16, 2011

- ▶ Staff briefing on the Montana individual income tax structure including conformity with the federal individual income tax, provisions related to married filers, and Montana-specific deductions, exclusions, exemptions, credits, and other special tax provisions.
- ▶ Staff review of the legislative history of conformity with federal individual income tax, provisions related to married filers, and Montana-specific deductions, exclusions, exemptions, credits, and other special tax provisions.
- ▶ Committee work session to focus study and identify core areas of interest.