IMPACTS OF FEDERAL TAX LAW CHANGES

Under The

Federal Jobs and Growth Tax Relief Reconciliation Act

A Report Prepared for the

Legislative Finance Committee

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INTRODUCTION

President Bush signed the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) in late May. In addition to state fiscal relief funds (discussed in a separate Legislative Fiscal Division report), the bill includes numerous federal tax law changes. Since Montana's tax law is based on the federal tax laws, JGTRRA will have significant impacts on state individual and corporation license tax collections, beginning in fiscal 2004. The impacts will be both positive and negative.

Until a full analysis of JGTRRA is complete, the net impact to state revenue collections will not be known. The main taxation provisions are described below, summarizing what is known as of this printing. The Legislative Fiscal Division will provide an updated report as soon as estimates are available.

Montana's individual income tax revenues will be subject to both positive and negative effects resulting from JGTRRA provisions. However, corporation license taxes are expected to decrease. Most of the provisions are temporary, and except where mentioned, are effective after December 31, 2002.

ACCELERATE THE INCREASE IN THE CHILD CREDIT

The JGTRRA increases the amount of the child credit from $600 to $1,000 for 2003 and 2004. This increase is temporary, and after 2004 the credit will revert to the level provided under present law ($700 in 2005). For tax year 2003, the increased amount of the child credit (up to $400) will be paid in advance, beginning in July 2003, based on the information contained in the taxpayer's 2002 tax return. The provision will reduce federal income tax revenues and increase Montana individual income tax revenues.

ACCELERATE MARRIAGE PENALTY RELIEF

Two provisions of JGTRRA will temporarily provide relief from marriage penalties. The provisions will apply to tax years 2003 and 2004, after which the laws will revert to the present law phase-in of both of the provisions. Both provisions are expected to increase state individual income tax collections.

- The basic standard deduction amount for married taxpayers filing a joint return will now be twice the basic standard deduction amount for single individuals for 2003 and 2004.
- The size of the 15 percent regular income tax rate bracket for married taxpayers filing joint returns will now be twice the width of the same bracket for single returns for taxable years of 2003 and 2004.

ACCELERATE REDUCTIONS IN INDIVIDUAL INCOME TAX RATES

Three JGTRRA provisions will accelerate the reduction of individual income tax rates, scheduled to become effective between tax years 2004 through 2008. The provisions are temporary. However, except where noted, present law changes will occur as scheduled. The state revenue effects of these provisions are expected to be positive because these provisions will reduce federal income taxes.

- For tax year 2003, the taxable income level for the 10 percent regular income tax rate bracket for single individuals is increased from $6,000 to $7,000, and twice that amount for married taxpayers filing joint returns. For 2004, these amounts will be indexed for inflation.
- In tax year 2003 and forward, marginal tax rates in excess of 15 percent will be 25 percent, 28 percent, 33 percent, and 35 percent. Because the provision does not modify the application of present-law implemented by the Economic Growth and Tax Relief Reconciliation Act of 2001, the changes will, in effect, be permanent.

- The alternative minimum tax exemption amount is increased to $58,000 for married taxpayers filing joint returns and surviving spouses and $40,250 for unmarried taxpayers in taxable years 2003 and 2004.

CAPITAL GAINS AND DIVIDEND TAX RELIEF FOR INDIVIDUALS

Two provisions reduce the current tax rates applied to capital gains and dividends. Both provisions are temporary and will expire in 2009. The reductions of the capital gains tax and the dividend tax will have a positive effect on state individual income tax collections.

The tax rate on capital gains and dividend rates will be reduced from 10 and 20 percent to 5 percent (0 percent in 2008) for individuals in the 10 percent and 15 percent income tax brackets and 15 percent for individuals in tax brackets greater than 15 percent. The lower rates apply to both the regular tax and the alternative minimum tax and only to assets held more than one year. The capital gains provision becomes effective on or after May 6, 2003, while the dividends provision is effective January 1, 2003.

GROWTH INCENTIVES FOR BUSINESS

The JGTRRA provides two incentives to encourage new business investment. Both provisions will have a negative impact on state individual income and corporation license tax revenues.

- The first year depreciation deduction (bonus depreciation) implemented by the Job Creation and Workers Assistance Act of 2002 is increased from 30 to 50 percent and extended to purchases through 2004. Property does not qualify if there was a binding written contract for the acquisition in effect before May 6, 2003. The provision is effective for taxable years ending after May 5, 2003.
- The maximum dollar amount deducted under Internal Revenue Code section 179 expensing is increased from $25,000 to $100,000 for property placed in service in taxable years 2003 through 2005. In addition, for purposes of the phase-out of the deductible amount, the $200,000 amount is increased to $400,000 for property placed in service in taxable years of 2003 through 2005. The dollar limitations are indexed annually for inflation for the taxable years of 2004 and 2005. The provision also includes off-the-shelf computer software placed in service in the taxable years of 2003 through 2005 as qualifying property. With respect to the taxable years of 2003 through 2005, the provision permits taxpayers to make or revoke expensing elections on amended returns without the required consent. The provision becomes effective January 1, 2003.

CORPORATE ESTIMATED TAXES

The JGTRRA provides that 25 percent of corporate estimated tax payments due on September 15, 2003 are not required to be paid before October 1, 2003. This provision will have no effect on state tax revenue collections.

SUMMARY

Provisions of the JGTRRA will have significant impacts on both Montana's individual income tax and corporation license tax revenue collections. Most of the provisions create a reduction in federal tax liability, which will cause a corresponding increase in Montana tax liability, resulting from the current federal tax deductibility. Business taxes will be reduced temporarily through the changes in federal depreciation and expensing rules. The reductions will be similarly reflected in Montana's individual income and corporation license tax revenues in fiscal 2004 and 2005. Preliminary analysis suggests that the aggregate effect of the JGTRRA will be a nearly complete offset of increased and decreased revenues in fiscal 2004, and Montana could experience an increase in tax revenues in fiscal 2005.