



GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Fiscal Note 2025 Biennium

Bill information:

HB0911 - Generally revise individual income tax laws (Karlen, Jonathan)

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

	<u>FY 2024</u> <u>Difference</u>	<u>FY 2025</u> <u>Difference</u>	<u>FY 2026</u> <u>Difference</u>	<u>FY 2027</u> <u>Difference</u>
Expenditures:				
General Fund	\$0	\$891,418	\$578,728	\$586,175
Revenue:				
General Fund	(\$13,672,000)	(\$220,504,000)	(\$229,613,000)	(\$234,393,000)
Net Impact-General Fund Balance:	<u>(\$13,672,000)</u>	<u>(\$221,395,418)</u>	<u>(\$230,191,728)</u>	<u>(\$234,979,175)</u>

Description of fiscal impact: HB 911 creates a child tax credit, increases the Earned Income Tax Credit percentage, and creates a property tax circuit breaker tax credit. The bill also changes personal income tax rates and changes the taxation of capital gains income.

FISCAL ANALYSIS

Assumptions:**Department of Revenue**

1. HB 911 makes several changes to Montana personal income tax. First, the bill creates a \$1,200 tax credit for children below the age of six. Second, the bill increases the state Earned Income Tax Credit (EITC) from 3% of the federal credit to 25%. Third, the bill increases the number of income tax rates from two to six. Fourth, the bill eliminates the state 30% capital gains deduction and replaces it with two separate capital gains tax rates. Finally, the bill creates an income tax credit that is based on property taxes, or rent equivalent property tax paid, by the taxpayer.

Child Tax Credit

2. Under section 24 of the Internal Revenue Code (26 U.S.C 24), a taxpayer is allowed to claim a tax credit that is equal to \$2,000 for each qualifying child of the taxpayer against their federal personal income taxes. To qualify, the child must be below the age of 17 at the end of the year. The credit amount is reduced based on the taxpayer's modified adjusted gross income, with a phase-out for income above \$400,000 for a joint return and \$200,000 for all other returns. A portion of the credit is currently refundable. The credit amount, phase-

out amounts, and other portions of the credit are set to change starting TY 2026. The State of Montana does not have a similar child tax credit under current law.

3. HB 911 creates a state child income tax credit, which would be available starting TY 2024. To qualify for the credit, taxpayers must file a resident tax return and qualify for the federal child tax credit. In addition, taxpayers must also have proof of earned income, investment income of less than \$10,300, and have a valid social security number for each child claimed. The requirement for earned income does not apply if the taxpayer is the parent of a child eligible to receive home and community-based services, or receives social security disability or veteran disability payments, or is a grandparent who claims a grandchild as a dependent. The credit is fully refundable.
4. The tax credit is \$1,200 for each qualifying child below the age of six, with the credit decreasing by \$90 for each \$1,000 the taxpayer’s Federal Adjusted Gross Income (AGI) is above \$50,000. The credit is completely eliminated for taxpayers with a Federal AGI in excess of \$56,000.
5. In TY 2021, 131,094 full-year and partial-year taxpayer households claimed at least one dependent on their Montana personal income tax return. These households claimed a total of 246,818 dependents.
6. Of the 131,094 households that reported a dependent, 54,217 met all the income qualifications for the credit. These households reported 96,600 dependents and qualified for \$112,871,880 in child tax credits based on their income and dependents.
7. The Montana income tax return does not contain the age of dependents.
8. According to Montana Census and Economic Information Center’s Population Projections, children between the ages of zero and five will, on average, comprise 29.75% of the population between the ages of zero and 18 during TY 2024, TY 2025, TY 2026, and TY 2027.
9. It is assumed that 29.75% of the \$112,871,880 in potential child tax credits will be associated with dependents who meet the age requirement for the credit.
10. In total \$33.579 million (\$112,871,880 X 29.75%) in annual child credits could be claimed starting TY 2024.
11. As the credit is dependent on the income, and sources of income, of the taxpayer, it is assumed that taxpayers will not change their withholding, or estimated payments, as a result of the proposed credit.
12. With no changes to withholding, or estimated payments, the credit will reduce income tax revenue when taxpayers file their returns the following fiscal year.
13. With \$33.579 million in credits each tax year, and no changes to withholdings or estimated payments, the proposed credit will reduce general fund revenue by \$33.579 million every fiscal year starting FY 2025.

Earned Income Tax Credit

14. Under current law, the department’s income tax model estimates that taxpayers will claim approximately \$4.749 million in Montana EITC credits in TY 2024. This decreases slightly to \$4.748 by TY 2027.
15. Based on forecasted EITC amounts, increasing Montana EITC credit share from 3% to 25% would increase the number of credits claimed to \$39.573 million in TY 2024. This is an increase of \$34.824 million relative to current law. By TY 2027, the number of EITC credits are estimated to be \$39.566 million.

Earned Income Tax Credit Estimates			
Tax Year	Credits Claimed (Millions)		
	Current Law	Proposed Law	Change in Revenue
2024	\$4.749	\$39.573	(\$34.824)
2025	\$4.748	\$39.565	(\$34.817)
2026	\$4.748	\$39.566	(\$34.819)
2027	\$4.748	\$39.566	(\$34.819)

16. It is assumed that taxpayers will not make changes to withholding or estimated payment amounts because of the EITC changes. Based on this assumption, the EITC changes will reduce income tax revenue when taxpayers file their returns the following tax and fiscal year.
17. With no changes to withholdings or estimated payments, the EITC expansion will reduce general fund revenue by \$34.824 million in FY 2025, \$34.817 million in FY 2026, and \$34.819 million in FY 2027.

Income Tax Rate Changes and Capital Gains Changes

18. HB 911 changes the number of income tax rates from 2 (4.7% and 6.5%) to six (4.7%, 5.9%, 6.5%, 7.5%, 8.2% and 8.9%).
19. HB 911 also eliminates the 30% net long-term capital gains tax deduction that was set to take effect starting TY 2024. In its place, separate capital gains tax rates for net long-term capital gains income are created with tax rates of 3.0% and 4.1%.
20. The department’s income tax model was modified to include the changes made by the proposed bill. The estimated income tax liability amounts for each tax year under the proposed bill were then compared to current law income tax liability forecasts.
21. Based on model results, changing the income tax rates and changing how capital gains are taxed would be expected to reduce the tax liability of full-year resident taxpayers by \$61.84 million in TY 2024, \$68.61 million in TY 2025, \$70.22 million in TY 2026, and \$71.93 million in TY 2027.

Tax Liability Estimates Under Current Law and Proposed Law			
Tax Year	Current Law	Tax Liability (Millions)	
		Proposed Law	Change in Revenue
2024	\$1,832.79	\$1,770.95	(\$61.84)
2025	\$1,924.21	\$1,855.60	(\$68.61)
2026	\$2,050.05	\$1,979.82	(\$70.22)
2027	\$2,121.83	\$2,049.90	(\$71.93)

22. As the proposed rate changes will require the Department of Revenue to change its withholding tables, it is assumed that some of the taxpayers will change their withholding and estimated payment amounts as a result of the proposed bill. The estimates used in HJ 2 assume that 80% of TY 2024 liability and 20% of TY 2025 tax liability changes will occur in FY 2025. This distribution continues for all fiscal years.
23. It is assumed that the tax liability distribution changes made as a result of the tax rate change follow the pattern used in HJ 2 revenue forecasts.
24. The tax liability amounts from the proposed rate decrease were also adjusted using HJ 2 assumptions for non-full-year resident taxpayers, audit assumptions, and population increases.
25. Based on the adjustments used for HJ 2, the proposed rate changes and capital gains tax rate changes will reduce income tax revenue by \$13.672 million in FY 2024, \$72.499 million in FY 2025, \$79.234 million in FY 2026, and \$81.364 million in FY 2027.

Tax Revenue Change by Fiscal Year	
Fiscal Year	Change in Revenue (Millions of Dollars)
2024	(\$13.672)
2025	(\$72.499)
2026	(\$79.234)
2027	(\$81.364)

Property Tax Circuit Breaker

26. The most recent (TY 2021) Montana individual income tax return data is used for estimating the impact of the tax credits created by HB 911. Returns with an itemized property tax deduction or elderly homeowner property tax credits were matched by mailing address with class 4 residential property tax data.
27. Of the 211,610 households with itemized property tax deductions, 165,392 were successfully matched. This is a match rate of 78.16%. It is assumed that the unmatched properties (21.94%) do not differ significantly in income or property characteristics from the matched households and that an equal percentage of non-itemizers will also not be matched successfully.
28. All income tax returns were matched with property tax records generating a total of 229,677 unique properties matched income and property record.

29. From this dataset, homeowner credits are estimated at \$55.898 million with 58,244 total claimants. Adjusted by the match rate of 78.16% the estimate for total homeowner credits is \$71.519 million spread over 74,520 claimants. Average credit size is \$960.
30. To estimate the number of renters who would use this credit, the participants who claimed the Elderly Homeowner and Renter Credit for rent equivalent property tax paid had their credit amounts simulated under HB 911. Those credits amounted to \$2.733 million and had 3,609 claimants. Average credit amount is \$757.
31. The *American Community Survey* administered by the U.S. Census publishes estimates of renter households by age. In 2021 approximately 20.52% of renters are 62 years or older in age (the age necessary to qualify for the Elderly Homeowner and Renter Credit).
32. It is assumed that non-elderly renters have similar rents and incomes to those 62 or older. Dividing the estimates from the current participants in the Elderly Homeowner and Renter Credit by the proportion that are elderly yields the estimate for the total renter population. That results in 17,591 estimated claimants with total credits of \$13.322 million.
33. The estimated sum of credits under the proposed program is estimated at \$84.841 million with 92,111 households qualifying for the credit.
34. HB 911 allows for taxpayers to take either the circuit breaker credit or the Elderly Homeowner and Renter Credit. If all taxpayers were better under the circuit breaker, the elimination of the Elderly Homeowner and Renter credit would save \$7.049 million.
35. There are 5,314 taxpayers expected to be better off under the Elderly Homeowner and Renter Credit, and the total difference between their credit size is approximately \$1.033 million. This is an additional program cost.
36. Total program costs are estimated at \$78.825 million (\$84.841 - \$7.049 + \$1.033), with about 87,000 households taking the circuit breaker credit.
37. The HB 911 circuit breaker credit would first apply to TY 2024, which corresponds with FY 2025 revenue. The estimated credit claims are grown by the “All Other Credits” growth factors contained in HJ 2. That results in fiscal year tax credits of \$79.342 million in FY 2025, \$81.715 million in FY 2026, and \$84.355 million in FY 2027.

Combined Change in Revenue

38. The combined cost of each provision in HB 911 is \$13,672,000 in FY 2024, \$220,504,000 in FY 2025, \$229,613,000 in FY 2026, and \$234,393,000 in FY 2027.

Combined Change in Revenue					
Fiscal Year	Child Tax Credit	Earned Income Tax Credit	Rate and Capital Gains Changes	Circuit Breaker Tax Credit	Combined
2024	\$0	\$0	(\$13,672,000)	\$0	(\$13,672,000)
2025	(\$33,579,000)	(\$34,824,000)	(\$72,499,000)	(\$79,602,000)	(\$220,504,000)
2026	(\$33,579,000)	(\$34,817,000)	(\$79,234,000)	(\$81,983,000)	(\$229,613,000)
2027	(\$33,579,000)	(\$34,819,000)	(\$81,364,000)	(\$84,631,000)	(\$234,393,000)

Department of Revenue Costs

39. The expected number of credit applicants for the Circuit Breaker Credit created by HB 911 will necessitate an additional 12.00 FTE in the Business and Income Taxes Division for the initial year. Subsequent years will require 8.00 FTE after filing history has been established.

Fiscal Impact:	FY 2024 Difference	FY 2025 Difference	FY 2026 Difference	FY 2027 Difference
Department of Revenue				
FTE	0.00	12.00	8.00	8.00
Expenditures:				
Personal Services	\$0	\$752,758	\$507,848	\$513,951
Operating Expenses	\$0	\$138,660	\$70,880	\$72,224
TOTAL Expenditures	\$0	\$891,418	\$578,728	\$586,175
Funding of Expenditures:				
General Fund (01)	\$0	\$891,418	\$578,728	\$586,175
TOTAL Funding of Exp.	\$0	\$891,418	\$578,728	\$586,175
Revenues:				
General Fund (01)	(\$13,672,000)	(\$220,504,000)	(\$229,613,000)	(\$234,393,000)
TOTAL Revenues	(\$13,672,000)	(\$220,504,000)	(\$229,613,000)	(\$234,393,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	(\$13,672,000)	(\$221,395,418)	(\$230,191,728)	(\$234,979,175)

Technical Notes:

- HB 911 creates separate capital gains tax rates of 3.0% and 4.1% in section 11 of the bill. However, there is language in the section that indicates an additional tax rate was intended, but not included. For example, 15-30-2103(2)(a)(ii), MCA, in the bill states, “on net long-term capital gains that exceed \$41,000 less nonqualified taxable income but are less than \$400,000 less nonqualified taxable income, 4.1%” The \$400,000 income amount indicates a different tax rate for income above the income threshold. However, no different tax rate is provided.

NOT SIGNED BY SPONSOR

			3-29-23
<i>Sponsor's Initials</i>	<i>Date</i>	<i>Budget Director's Initials</i>	<i>Date</i>