Montana Department of Revenue

Mike Kadas
Director

Steve Bullock
Governor

Memorandum

To: Director Kadas

From: Rose Bender, Economist RB

Date: December 4, 2017

Subject: Federal Tax Reform Corporate Estimate

There are a number of proposed changes to federal corporate income tax that would affect Montana, largely due to changes in federal taxable income. To estimate the impact to Montana's corporate income tax revenue, where available, the estimated revenue effects of the "Tax Cuts and Jobs Act", as ordered reported by the Committee on Finance on November 16, 2017, from the Joint Committee on Taxation (JCT) were used. These estimates were scaled down to Montana proportions. The estimate for increased expensing or 100 percent bonus depreciation relies on the department's estimate for bonus depreciation revenue loss in 2015 and, based on corporate income tax filings at that time, and current knowledge of corporate income tax filings.

The following table outlines estimated revenue changes of the major provisions affecting corporate income tax revenue by tax year. Please note that corporate income tax revenues experience great volatility, and specific information on how these proposals would be implemented in relation to federal taxable income is needed for a more accurate estimate.

This proposed legislation has been amended multiple times, and likely these amendments will continue. Current amendments have been reviewed and significant changes to the following estimates are not expected from estimates in the upcoming biennium, as reported in the following table.

Following the table is a more detailed description of the proposals.

Estimated Changes in Montana Corporate Income Tax Revenues (millions)

Provision	TY 2018	TY 2019
Reduction of dividends received deduction	$0.0	$0.0
Increase expensing/bonus deprecitation	($18.0)	($16.6)
Expansion of section 179 expensing	($0.4)	($0.7)
Small business accounting method reform and simplification	($1.0)	($0.8)
Limit net interest deductions to 30% of adjusted taxable income, carryforward of denied deduction	$2.8	$4.5
Modification to treatment of certain farm property	($0.3)	($0.3)
Repeal like-kind exchanges except for real property	$0.1	$0.1
Applicable recovery period for real property	($0.0)	($0.1)
Repeal of deduction for income attributable to domestic production activities	($0.0)	$0.4
Limitation on deduction by employers on expenses with fringe benefits	$0.3	$0.4
Accounting method changes	$0.4	$0.5
Territorial system summary		
Deduction for dividends received by domestic corps from certain foreign corporations	($2.0)	($3.0)
Treatment of deferred foreign income upon transition to participation exemption system of taxation - "deemed repatriation"	$5.2	$2.5
Total General Fund Impact	($13.0)	($13.2)

Business Tax Reform

Full Depreciation and expansion of expensing – In the short-term this will be a loser for the state. Under current law the depreciation is spread over several years. The proposed change will allow full depreciation of the investment in the first year. The increased limits on expensing section 179 property would also negatively impact Montana corporate income tax revenues. (-)

Reduction of dividends received deduction – This proposal reduces the dividends received. This would increase the corporate income tax base and increase corporate income tax revenues in Montana. (+)

Small business accounting method reform and simplification – This proposal modifies accounting rules that would negatively impact Montana corporate income tax revenues. (-)

Interest – A disallowance of a deduction for net interest expense of 30% of the businesses' adjusted taxable income would increase Montana corporate income tax revenues. (+)

Like-kind exchange limited to real property – Repealing the deferral of gain from like-kind exchanges, except for real property would increase Montana corporate income tax revenue. (+)

International Tax Reform

Territorial Tax System – A territorial tax system is proposed where US companies would generally pay tax only on domestic income, not foreign-derived income. The proposed changes could result in less corporate income tax revenue Montana receives from corporations, but the effect depends on how the changes are implemented at the federal level, in reference to federal taxable income.

Repatriation of Foreign Income – US multinationals would include as taxable income the proportionate share of qualified untaxed income from their foreign subsidiaries in which they have 10% or more ownership. The effect from this repatriation would depend on where this income is on the federal form. If it is included in line 28, Montana would have an increase in corporate income tax revenue. If not, there would be no change.