SB 407, adopted by the legislature in 2003, reduced individual income tax revenue and adopted limited sales and use taxes.

SB 407 adjusted individual income tax in three ways:

1. Restructured income tax rates, by reducing the number of tax brackets from ten to six. This reduced the bottom rate from 2% to 1%, and reduced the top rate from 11% to 6.9%.
2. Reduced revenue collections on capital gains income by giving a non-refundable tax credit equal to 1% of capital gains income in 2006 and 2007, and 2% of capital gains income beginning in 2008.
3. Capped itemized deduction for federal income taxes. Previously, federal income taxes paid during the tax year could be deducted in full.

SB 407 implemented a 52-cent increase in the cigarette tax and other tobacco products, a tax on rental cars, and a new 3% sales tax on lodging accommodations.

The original fiscal note for SB 407 showed an estimated $24.2 million net increase in FY 2005 to the state general fund as shown in the table at right.

However, the fiscal note stated that since the capital gains credit would increase to 2% by FY 2008, the long-term impact on general fund revenues would be negative ($17.0) million by FY 2008.

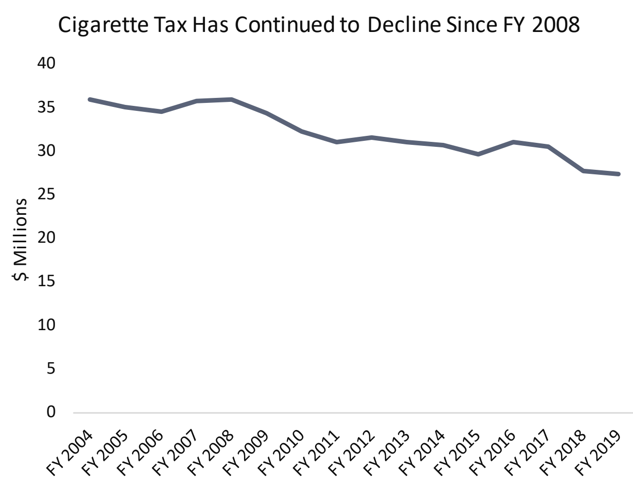
SB 407 Fiscal Note FY 2005 Estimated General Fund Revenues

$ Millions

Cigarette tax increase	$26.3
Other tobacco products tax increase	$0.8
Rental car tax	$2.2
Accommodation tax	$9.1
Transfer of excess 02260 fund balance	$1.5
Individual Income Tax Reductions	($15.8)
Total	$24.2

Revenue Impacts from SB 407

In FY 2005, cigarette tax revenues came in $8.8 million above original predictions in the fiscal note. Although cigarette revenues were more than expected in FY 2005, over time the source has declined. The SB 407 fiscal note estimated cigarette tax revenue based on the price elasticity of demand for cigarettes and did not forecast declines in consumption of taxable cigarettes due to the impacts of future local and state government resolutions providing for non-smoking ordinances.[1] Smoking bans implemented in October 2005 in Montana public places contributed to the decline in cigarette tax as cigarette use has diminished.

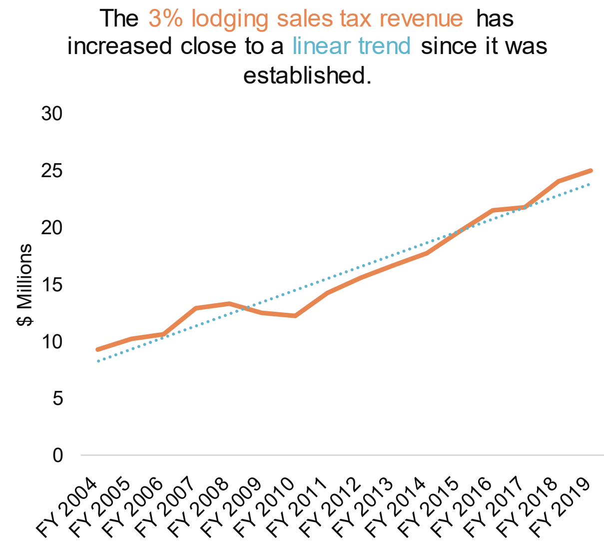


General fund revenues derived from the implementation of the new rental car tax and the accommodation tax also came in slightly above the estimated

[1] SB 407 fiscal note, 2003 legislative session, April 9, 2003, assumption #29, page 3.

fiscal note, generating an additional $1.5 million in FY 2005. Rental car tax continues to be a small general fund revenue source, just 0.2% of total general fund revenue in FY 2019.

The lodging sales tax is 3%, with all proceeds going to the general fund until January 1, 2020. Revenue generated from the lodging sales tax has shown predictable and steady growth (9% compound annual growth) since the great recession as indicated in the chart at right.



Individual Income Tax Reductions

The SB 407 fiscal note projected that individual income tax reductions in FY 2005 would total ($15.8) million.

In 2006, the Department of Revenue reported that SB 407 tax policy changes to individual income tax resulted in 2005 individual income tax reductions of ($100.3) million. The percentage reductions going to lower and higher income taxpayers were larger than expected, and the percentage reductions going to middle income taxpayers were smaller.[2]

The net impact was a negative ($47.7) million reduction in individual income tax revenues instead of a $24.2 million increase as estimated by the fiscal note. The original fiscal note did not predict a negative impact to individual income tax revenues until FY 2008, when it was estimated that the impacts of increasing the capital gains credit to 2% would negatively impact individual income tax revenues.

SB 407 Impacts on 2005 General Fund Revenues

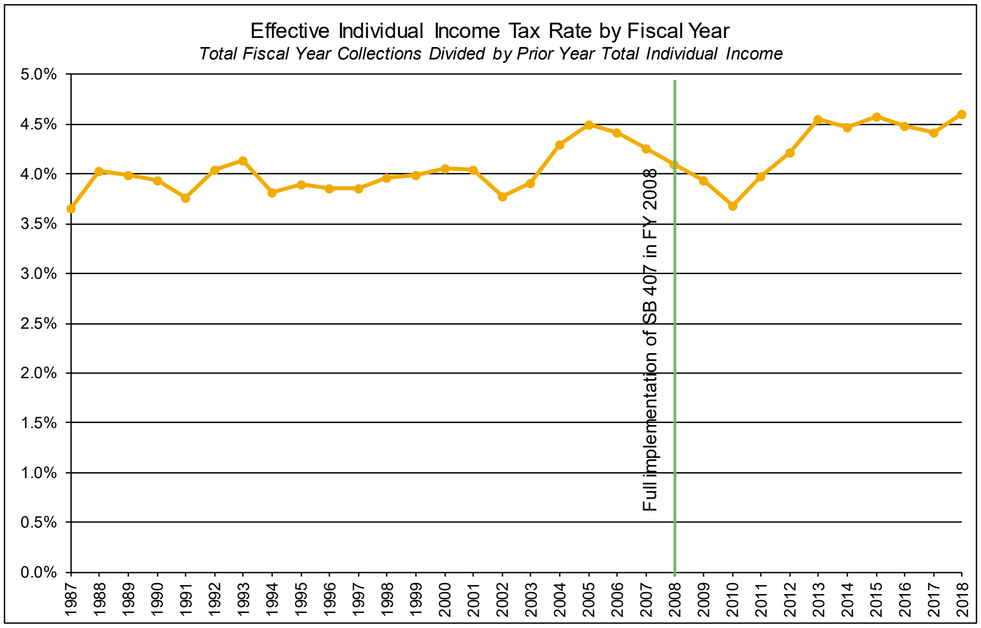
$ Millions

Cigarette tax increase	$35.1
Other tobacco products tax increase	$1.9
Rental car tax	$2.6
Accommodation tax	$10.2
Transfer of excess 02260 fund balance	$2.9
Individual Income Tax Reductions as reported by DOR**	($100.3)
Total	($47.7)

** CY 2005 is assumed to reflect fiscal year impact.

[2] The Revenue and Taxpayer Impacts of the Income Tax Provisions of SB 407, Montana Department of Revenue, December 2006, page 2.

The largest portion of the individual income tax reductions imposed by SB 407, was the 2% capital gains tax credit. By FY 2008 when the full effects of the SB 407 tax credit of 2% was allowed, taxpayers claimed $26.2 million worth of this credit on their CY 2008 tax returns[3]. By CY 2017 this amount had grown to $44.6 million[4]. While these tax expenditures have grown over time, analyses suggest that there could be more higher income individuals paying individual income taxes in Montana since the passage of the bill. The state's individual income effective tax rate, defined as taxes owed divided by total income, has grown from 4.1% in FY 2008 to 4.6% in FY 2018. This is illustrated in the figure below. With constant tax brackets, this could only occur if total income increases.



The complete impact of SB 407 of the 2003 session is unknown. There is not data to know if the higher effective tax rate is the result of SB 407 attracting higher income individuals, incomes increasing as they would have otherwise, or other individual taxpayer decisions. The 0.5% increase in effective tax rate shown above nets the state about $145 million per year.

[3] Montana Department of Revenue Biennial Report , July 1, 2008-June 30, 2010, page 60

[4] Montana Department of Revenue Biennial Report, July 1, 2016-June 30, 2018, page 63