

**OFFICE OF THE GOVERNOR**  
**BUDGET AND PROGRAM PLANNING**  
STATE OF MONTANA



GREG GIANFORTE  
GOVERNOR

PO Box 200802  
HELENA, MONTANA 59620-0802

To: Kurt Alme, Anita Milanovich

From: Chris Watson, OBPP

Date: 8/12/2021

Subject: American Rescue Plan Act Net Tax Reduction Provision

**Analysis of ARPA Net Tax Reduction Provision for Montana**

**Recommendation:** Montana is not expected to have a reduction in net tax revenue in any year during the covered period. The net revenue impact of covered changes for fiscal years within the covered period is more than offset by organic revenue growth, resulting in Montana meeting the safe harbor condition outlined in Treasury’s Interim Final Rule.

**Disclaimer:** This recommendation is based on the most recent Treasury guidance available as of the date of this memorandum. There remains a possibility that a change in the Treasury Rules, Treasury guidance, changes to federal law, or the outcome of pending or forthcoming litigation may result in this recommendation changing.

**Background**

The American Rescue Plan Act (ARPA) contains a host of provisions on how Fiscal Recovery Funds distributed to States are to be used for the purposes of responding to the COVID-19 public health emergency. One such condition, referred to as the “offset provision”, prohibits States from using their fiscal recovery funds to finance a reduction in net tax revenue. Section 602(c)(2)(A) of the American Rescue Plan Act states:

*“A State or territory shall not use the funds provided under this section or transferred pursuant to section 603(c)(4) to either directly or indirectly offset a reduction in the net tax revenue of such State or territory resulting from a change in law, regulation, or administrative interpretation during the covered period that reduces any tax (by providing for a reduction in a rate, a rebate, a deduction, a credit, or otherwise) or delays the imposition of any tax or tax increase.”<sup>1</sup>*

To ensure States comply with this instruction, Treasury’s Interim Final Rule (IFR) provides guidance for determining if a State will have a reduction in net tax revenue during the covered period beginning March 3, 2021 and ending December 31, 2024. A reduction in net tax revenue will be determined to have occurred if a change in law or other similar action during the covered

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<sup>1</sup>American Rescue Plan Act of 2021, H.R. 1319, Section 602(c)(2)(A)

period causes net tax revenue in a reporting year to fall below the calculated baseline in an amount that exceeds the allowable *de minimis* level. The IFR explains a covered change – that is, what constitutes a qualifying action that may result in a reduction of tax revenue:

*“A covered change includes any final legislative or regulatory action, a new or changed administrative interpretation, and the phase-in or taking effect of any statute or rule where the phase-in or taking effect was not prescribed prior to the start of the covered period.”<sup>2</sup>*

Further, the IFR specifies that tax-reducing actions must be initiated by the State:

*“Moreover, only the changes within the control of the State or territory are considered covered changes. Covered changes do not include a change in rate that is triggered automatically and based on statutory or regulatory criteria in effect prior to the covered period.”<sup>3</sup>*

## Analysis

The IFR allows States to use their existing budgeting processes and revenue estimate methodologies to make the net tax reduction determination. For Montana, the net revenue impacts of legislative changes from the 2021 session that affect tax or fee revenue within the covered period constitute the covered changes pertinent to the offset provision. This information is gathered from fiscal notes associated with the relevant legislation. Collaboration among OBPP, the Legislative Fiscal Division, and the Department of Revenue helped identify all legislation that falls under the umbrella of the offset provision. The net impact of Montana’s relevant legislation is negative in each year during the period FY 2022 – FY 2025. The largest impacts occur in FY 2024 and FY 2025, a result of changes to Montana’s income tax rates. The list of included bills and their annual fiscal impacts is presented in the appendix. A summary of the annual net revenue impacts for all qualifying legislation is shown in table 1. These figures do not include revenue from the taxation of recreational marijuana for reasons discussed later in this analysis.

Table 1.

<b>Net Revenue Impact of Montana Covered Changes</b>				
FY 2022 - FY 2025, \$ millions				
	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>
Net Revenue Impact	-\$2	-\$25	-\$45	-\$67

The next step is to determine if the above fiscal impacts might be enough to cause a net tax reduction in any year. Nominal tax revenue is estimated for each reporting year, incorporating each year’s net revenue changes. This nominal level of tax revenue is compared to a baseline figure, which is FY 2019 tax revenue adjusted for inflation in each reporting year.<sup>4</sup> If nominal tax revenue is greater than the baseline there is no net tax reduction and Montana is not subject to

<sup>2</sup> U.S. Department of the Treasury. Interim Final Rule, page 83. <https://home.treasury.gov/system/files/136/FRF-Interim-Final-Rule.pdf>

<sup>3</sup> U.S. Department of the Treasury. Interim Final Rule, page 84. <https://home.treasury.gov/system/files/136/FRF-Interim-Final-Rule.pdf>

<sup>4</sup> U.S. Department of the Treasury. Interim Final Rule, pages 86-87. <https://home.treasury.gov/system/files/136/FRF-Interim-Final-Rule.pdf>

the stipulations of the offset provision because the state is deemed to have “paid” for the net tax reduction with organic revenue growth. The IFR refers to this outcome as being in safe harbor.

In the absence of safe harbor – i.e., nominal tax revenue is below the baseline – Montana will still be in the clear if the total amount of the revenue-reducing changes is less than 1% of the baseline. This is the *de minimis* level. Revenue decline that is less than the *de minimis* amount is allowable because Treasury is aware that States may enact minor administrative or policy changes that have minimal effects on tax and fee collections. The IFR guidance includes the following language:

*“The de minimis level recognizes the inherent challenges and uncertainties that recipient governments face, and thus allows relatively small reductions in tax revenue without consequence.”*<sup>5</sup>

Projections indicate that Montana’s total value of covered changes in FYs 2024 and 2025 will likely be above the *de minimis* amount; however, this is not a concern because the same projections show Montana being comfortably in safe harbor for each reporting year in the covered period. Nominal tax revenue is forecast using trend growth and then adjusted for each year’s covered changes. Baseline tax revenue is adjusted for inflation using the Bureau of Economic Analysis’s Implicit Price Deflator.<sup>6</sup> The economic forecasting service used by OBPP, IHS Markit, has a long-term projection of this inflation metric, and their estimates are employed to forecast baseline tax revenue for this analysis. Nominal tax revenue outstrips baseline tax revenue by a wide margin in each reporting year. See table 2 for a detailed, yearly breakdown of the estimate methodology.

Estimates in table 2 are presented with and without recreational marijuana revenue. There is uncertainty about whether the legalization and taxation of recreational marijuana qualifies as a covered change because its approval by the Montana electorate occurred before the covered period. However, House Bill 701 from the 2021 legislative session made changes to the recreational marijuana law originally passed by Montana voters and was enacted during the covered period, lending credence to a decision to include recreational marijuana tax revenue in the calculation of net tax revenue. In this case, the net effect of Montana covered changes moves from negative to positive and no safe harbor or *de minimis* calculation is needed.

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<sup>5</sup> U.S. Department of the Treasury. Interim Final Rule, page 90. <https://home.treasury.gov/system/files/136/FRF-Interim-Final-Rule.pdf>

<sup>6</sup> U.S. Department of Commerce, Bureau of Economic Analysis, GDP Price Deflator, <https://www.bea.gov/data/prices-inflation/gdp-price-deflator>

Table 2.

<b>Net Tax Reduction Estimates for Montana</b>				
FY 2022 - FY 2025, \$ millions				
	<b>FY 2022</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>
Baseline Tax Revenue	\$3,388	\$3,457	\$3,533	\$3,616
Baseline Growth Rate	3.3%	2.0%	2.2%	2.3%
<i>Exclude HB 701 Recreational Marijuana Revenue</i>				
Nominal Tax Revenue*	\$3,458	\$3,589	\$3,706	\$3,805
Nominal Relative to Baseline	\$70	\$132	\$173	\$190
Safe Harbor?	YES	YES	YES	YES
Net Revenue Impact of Covered Changes	-\$2	-\$25	-\$45	-\$67
1% de Minimis	\$34	\$35	\$35	\$36
Reduction Less than <i>de minimis</i> ?	YES	YES	NO	NO
Pass Safe Harbor and/or <i>de minimis</i> Test?	YES	YES	YES	YES
<i>Include HB 701 Recreational Marijuana Revenue</i>				
Nominal Tax Revenue*	\$3,493	\$3,642	\$3,764	\$3,856
Nominal Relative to Baseline	\$104	\$185	\$231	\$240
Safe Harbor?	YES	YES	YES	YES
Net Revenue Impact of Covered Changes	\$35	\$53	\$58	\$51
1% de Minimis	\$34	\$35	\$35	\$36
Reduction Less than <i>de minimis</i> ?	YES	YES	YES	YES
Pass Safe Harbor and/or <i>de minimis</i> Test?	YES	YES	YES	YES

\* Adjusted for net impact of covered changes after base level of tax revenue is projected forward

Using the more conservative estimate that excludes recreational marijuana revenue, Montana lands in safe harbor by \$70 million in FY 2022, \$132 million in FY 2023, \$173 in FY 2024 and \$190 million in FY 2025. Barring any drastic deviations in nominal tax collections and/or inflation from expectation, Montana should not fall out of safe harbor protection throughout the covered period.

The estimates presented in this analysis do not constitute final numbers. Actual tax collections will be determined at the close of each reporting year, as will the final baseline level of tax revenue. Once these figures are known, the safe harbor and *de minimis* (if needed) calculations will be completed and officially reported.

## Appendix

Table 3. List of Bills from Montana 2021 Legislative Session Qualifying as Covered Changes

2021 Legislation Relevant to the Offset Provision of The American Rescue Plan Act						
\$ millions						
Tax or Fee Bill?	Reason Excluded	Bill # Title	FY 2022 Revenue	FY 2023 Revenue	FY 2024 Revenue	FY 2025 Revenue
No	Appropriation	HB10 - Long-Range Information Technology Appropriations	\$0	\$0	\$0	\$0
Yes		HB129 - Revise the Family Education Savings Act	-\$0.173	-\$0.377	-\$0.614	-\$0.889
Yes		HB131 - Generally revise state cabin leasing laws	\$0.840	-\$0.045	-\$0.045	-\$0.045
Yes		HB139 - Revise death certificate fees to fund board of morticians and funeral services	\$0.423	\$0.423	\$0.429	\$0.435
No	Bonding	HB14 - Long-Range Building Bonding Program	\$0	\$0	\$0	\$0
No	Federal revenue	HB155 - Revise laws related to reimbursement for certain Medicaid services	\$0	\$0	\$0	\$0
Yes		HB173 - Revise laws regarding state timber sales	\$0.040	\$0.040	\$0.040	\$0.040
Yes		HB191 - Revise residential property tax credit for elderly	-\$2.944	-\$2.839	-\$2.734	-\$2.629
Yes		HB217 - Provide for licensure of genetic counselors	\$0.052	\$0.039	\$0.040	\$0.040
Yes		HB252 - Non-refundable tax credit for employer-paid education of trade professions	-\$1.000	-\$1.000	-\$1.000	-\$1.000
Yes		HB260 - Revise non-resident fishing license fees	\$0.580	\$1.741	\$1.741	\$1.741
Yes		HB264 - Revise emergency vehicle passing laws	\$0.009	\$0.013	\$0.013	\$0.013
Yes		HB279 - Revise laws related to tax credit scholarship and innovative education programs	\$0.000	-\$1.907	-\$3.838	-\$4.611
Yes		HB290 - Provide for a self-storage insurance act	\$0.012	\$0.000	\$0.012	\$0.012
Yes		HB303 - Revise business equipment tax laws: Business Investment Grows (BIG) Jobs Act	-\$0.731	-\$1.140	-\$1.146	-\$1.150
No	Transfers	HB330 - Generally revise laws related to budget stability and managing volatility	\$0	\$0	\$0	\$0
Yes		HB340 - Revise the MEDIA Act film tax credits	\$0.005	-\$1.987	-\$1.983	-\$1.977
Yes		HB357 - Revise property tax assistance program inflation adjustment laws	-\$0.234	\$0.000	\$0.000	\$0.000
No	Transfers	HB373 - Revise natural resources operations fund, provide transfer	\$0	\$0	\$0	\$0

No	Transfers	HB374 - Amend Coal Severance Tax SSR accounts, provide transfers	\$0	\$0	\$0	\$0
No	No tax or fee	HB423 - Revise laws to provide for additional screening of newborn infants	\$0	\$0	\$0	\$0
No	Transfers / Federal revenue	HB425 - Generally revise crime victim compensation laws	\$0	\$0	\$0	\$0
Yes		HB445 - Generally revise automobile franchise laws	\$0.002	\$0.002	\$0.002	\$0.002
Yes		HB459 - Provide for certification of CPS workers with direct contact with children	\$0.098	\$0.066	\$0.065	\$0.065
Yes		HB468 - Allowing hound hunting and chase seasons for black bears	\$0.005	\$0.005	\$0.005	\$0.005
Yes		HB49 - Revise recording fees to support county and state land information accounts	\$0.828	\$0.828	\$0.828	\$0.828
No	Appropriation	HB5 - Long-Range Building Appropriations	\$0	\$0	\$0	\$0
Yes		HB517 - Revise penalties related to underage marijuana possession and use	-\$0.004	-\$0.004	-\$0.004	-\$0.004
Yes		HB525 - Generally revise laws related to alcohol concession agreements	\$0.005	\$0.006	\$0.007	\$0.008
Yes		HB593 - Generally revise barbering and cosmetology laws	\$0.000	\$0.015	\$0.015	\$0.015
Yes		HB599 - Generally revise opencut laws	-\$0.016	-\$0.016	-\$0.016	-\$0.016
No	Appropriation / Federal revenue	HB620 - Revise Title X appropriation	\$0	\$0	\$0	\$0
Yes		HB629 - Provide for job creation tax credits	\$0.000	-\$0.213	-\$0.479	-\$0.587
Yes		HB637 - Generally revise fish, wildlife, and parks laws	\$0.005	\$0.005	\$0.005	\$0.005
No	Transfers	HB66 - Reauthorize securities restitution fund	\$0	\$0	\$0	\$0
Yes		HB661 - Revise taxation of stripper oil and gas wells	-\$0.464	-\$0.435	-\$0.413	-\$0.401
No	Transfers	HB671 - Implement provisions of HB2 - Section E - education	\$0	\$0	\$0	\$0
No	Transfers	HB678 - Authorize transfers and other necessary measures to implement HB2 -section A	\$0	\$0	\$0	\$0
Yes		HB704 - Generally revise state lottery laws	\$1.000	\$1.000	\$1.000	\$1.000
Yes		HB705 - Generally revise alcohol and gaming laws	\$0.014	\$0.000	\$0.000	\$0.000
No	Transfers	HB72 - Revise funding for highway patrol retirement system HPORS	\$0	\$0	\$0	\$0
Yes		HB98 - Extending the Missing Indigenous Persons Task Force and the LINC grant program	\$0	\$0	\$0	\$0

Yes		SB106 - Establish license and qualifications for veterinary technicians	\$0.027	\$0.017	\$0.017	\$0.017
No	No tax or fee	SB110 - Revise state employee and U-system health plan laws for temp state share holiday	\$0	\$0	\$0	\$0
Yes		SB147 - Establish commercial property assessed capital enhancements program	\$0.007	\$0.020	\$0.026	\$0.033
Yes		SB159 - Personal Income Tax Relief Act	-\$5.962	-\$31.271	-\$33.114	-\$34.876
Yes		SB163 - Increase membership for the board of water well contractors	\$0.000	\$0.001	\$0.001	\$0.001
No	Transfers	SB175 - Generally revise contributions to the judges' retirement system	\$0	\$0	\$0	\$0
Yes		SB21 - Revise deposit of lobbying fee and repeal broadcasting special account	\$0	\$0	\$0	\$0
No	Transfers	SB230 - Repaying general fund for initial implementation of sage grouse act	\$0	\$0	\$0	\$0
Yes		SB243 - Create presumption of domicile for students who join Montana National Guard	-\$0.079	-\$0.081	-\$0.085	-\$0.088
Yes		SB247 - Generally revise alcohol state property/postsecondary education	\$0.131	\$0.133	\$0.136	\$0.139
Yes		SB263 - Revise forest lands property taxes and rates	-\$0.039	-\$0.080	\$0.000	\$0.000
Yes		SB269 - Allow mobile home owners the option to purchase a mobile home park	-\$0.029	-\$0.029	-\$0.029	-\$0.029
Yes		SB275 - Generally revise the board of outfitters and outfitting laws and enforcement	\$0.016	\$0.016	\$0.016	\$0.016
Yes		SB284 - Generally revise county gravel pit permitting	-\$0.056	-\$0.055	-\$0.055	-\$0.055
Yes		SB285 - Provide gas and fuel tax refund for agriculture	-\$0.096	-\$0.096	-\$0.096	-\$0.096
Yes		SB288 - Revise property exemption for agricultural processing facilities	\$0.000	\$0.000	\$0.000	\$0.000
No	No fiscal impact	SB297 - ConnectMT Act to establish broadband deployment	\$0.0	\$0.0	\$0.0	\$0.0
Yes		SB308 - Revise the Montana Building and Loan Associations Act.	\$0.010	\$0.018	\$0.018	\$0.018
Yes		SB320 - Generally revise business law pertaining to alcohol delivery	\$0.098	\$0.098	\$0.098	\$0.098
Yes		SB336 - Generally revise driver license laws	\$0.481	\$0.518	\$0.519	\$0.522
Yes		SB376 - Corporate tax modernization through double-sales factor apportionment	\$2.355	\$3.241	\$3.317	\$3.400

Yes		SB38 - Revised motorized trail program laws	\$0.000	\$0.079	\$0.000	\$0.079
Yes		SB384 - Revise laws related to Aquatic Invasive Species hydroelectric fee	-\$1.140	-\$1.140	-\$1.140	-\$1.140
Yes		SB388 - Provide for infrastructure through tax increment financing	\$0.000	\$0.039	\$0.040	\$0.040
Yes		SB395 - Montana Pharmacy Benefit Manager Oversight Act	\$0.012	\$0.009	\$0.008	\$0.008
Yes		SB398 - Generally revise vaping laws	\$0.008	\$0.083	\$0.083	\$0.083
Yes		SB399 - Generally revise and simplify income taxes	\$0.000	\$4.866	-\$10.306	-\$29.949
Yes		SB44 - Revise subdivision laws	\$0.000	\$0.000	-\$0.015	-\$0.015
Yes		SB51 - Exempting certain fiber optic, coaxial cable from property taxation	\$0.000	-\$0.031	-\$0.062	-\$0.093
Yes		SB52 - Revise lodging facility use tax and sales tax on lodging and rental cars	\$0.482	\$0.764	\$0.851	\$0.916
No	Transfers	SB58 - Provide fund transfer for livestock losses	\$0.0	\$0.0	\$0.0	\$0.0
Yes		SB76 - Revise the captive insurance regulatory and supervision account	\$0.230	\$0.237	\$0.000	\$0.000
Yes		SB81 - Include prepaid wireless in 9-1-1 tax	\$0.175	\$0.707	\$0.716	\$0.724
Yes		HB701 - Generally revise marijuana laws (MM tax increase revenue only)	\$3.100	\$2.790	\$2.512	\$2.260
		<b>Total (excludes recreational marijuana revenue)</b>	<b>-\$1.866</b>	<b>-\$24.928</b>	<b>-\$44.615</b>	<b>-\$67.088</b>
		HB701 – Generally revise marijuana laws (recreational tax revenue only)	\$36.711	\$77.935	\$103.083	\$117.605
		<b>Total (including recreational marijuana revenue)</b>	<b>\$34.794</b>	<b>\$53.007</b>	<b>\$58.468</b>	<b>\$50.517</b>