HOUSE BILL 447

Introduced by Cobb, et al.

1/29	Introduced
1/29	Referred to Taxation
1/30	First Reading
1/30	Fiscal Note Requested
2/04	Fiscal Note Received
2/05	Hearing
2/05	Fiscal Note Printed
3/07	Tabled in Committee

House BILL NO. 447

INTRODUCED BY Cobb

Foster NATHE Keating

A BILL FOR AN ACT ENTITLED: "AN ACT REVISING CERTAIN PROVISIONS RELATING TO THE TAXATION OF THE INCOME OF INDIVIDUALS AND CORPORATIONS; ALLOWING THE APPLICATION OF AN INFLATION FACTOR TO CAPITAL GAINS OR LOSSES FOR THE PURPOSES OF TAXATION; EXTENDING THE EXCLUSION OF INTEREST INCOME TO ALL INDIVIDUALS; INCREASING THE EXCLUSION OF INTEREST INCOME; ALLOWING THE APPLICATION OF AN INFLATION FACTOR TO INTEREST INCOME; AMENDING SECTIONS 15-30-111, 15-30-136, 15-31-114, AND 15-31-304, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE AND A RETROACTIVE APPLICABILITY DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 1.** **Inflation factor allowed on gain or loss on sale or exchange of certain capital assets -- duty of department -- rulemaking.** (1) With regard to capital assets purchased and sold after December 31, 1990, true gain rather than nominal gain must be used to determine the tax on the proceeds of the sale or exchange of certain capital assets.

(2) Adjusted gross income includes all capital gains or losses on the sale or exchange of capital assets purchased after December 31, 1990, as capital gains are determined under subchapter P. of Chapter 1 of the Internal Revenue Code as it read on December 31, 1986, and as adjusted for inflation by the department.

(3) The inflation factor to be used by the department in adjusting capital gains or losses must be based on the same methodology as the inflation factors defined in 15-30-101(8).

(4) Each year the department shall prepare and provide with the income tax forms the inflation adjustment factor to be used for the previous years' holding period.

(5) For capital assets held more than 1 year, the taxpayer may adjust the cost basis of the assets each year by the inflation adjustment factor for the previous years' holding period.

(6) The department shall adopt rules and provide forms for use by the taxpayer in making inflation adjustments of capital asset costs.

Section 2. Section 15-30-111, MCA, is amended to read:

"15-30-111. **Adjusted gross income.** (1) Adjusted gross income shall be the taxpayer's federal income tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954 or as that section may be labeled or amended and in addition shall include the following:

(a) interest received on obligations of another state or territory or county, municipality, district, or other

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political subdivision thereof;

(b) refunds received of federal income tax, to the extent the deduction of such tax resulted in a reduction of Montana income tax liability;

(c) that portion of a shareholder's income under subchapter S. of Chapter 1 of the Internal Revenue Code of 1954, that has been reduced by any federal taxes paid by the subchapter S. corporation on the income; and

(d) depreciation or amortization taken on a title plant as defined in 33-25-105(15).

(2) Notwithstanding the provisions of the federal Internal Revenue Code of 1954, as labeled or amended, adjusted gross income does not include the following which are exempt from taxation under this chapter:

(a) all interest income from obligations of the United States government, the state of Montana, county, municipality, district, or other political subdivision thereof;

(b) interest income earned by a taxpayer ~~age 65 or older~~ in a taxable year up to and including:

(i) ~~$800~~ $960 for a taxpayer filing a separate return, adjusted by the inflation factor for that taxable year and rounded to the nearest $10; and

(ii) ~~and $1,600~~ for each joint return, double the amount listed for a separate return in subsection (2)(b)(i);

(c) all benefits, not in excess of $3,600, received:

(i) under the Federal Employees' Retirement Act;

(ii) under the public employee retirement laws of a state other than Montana; or

(iii) as an annuity, pension, or endowment under any private or corporate retirement plan or system;

(d) all benefits paid under the teachers' retirement law which are specified as exempt from taxation by 19-4-706;

(e) all benefits paid under The Public Employees' Retirement System Act which are specified as exempt from taxation by 19-3-105;

(f) all benefits paid under the highway patrol retirement law which are specified as exempt from taxation by 19-6-705;

(g) all Montana income tax refunds or credits thereof;

(h) all benefits paid under 19-11-602, 19-11-604, and 19-11-605 to retired and disabled firefighters, their surviving spouses and orphans or specified as exempt from taxation by 19-13-1003;

(i) all benefits paid under the municipal police officers' retirement system that are specified as exempt from taxation by 19-9-1005;

(j) gain required to be recognized by a liquidating corporation under 15-31-113(1)(a)(ii);

(k) all tips covered by section 3402(k) of the Internal

Revenue Code of 1954, as amended and applicable on January 1, 1983, received by persons for services rendered by them to patrons of premises licensed to provide food, beverage, or lodging;

(l) all benefits received under the workers' compensation laws;

(m) all health insurance premiums paid by an employer for an employee if attributed as income to the employee under federal law;

(n) all benefits paid under an optional retirement program that are specified as exempt from taxation by 19-21-212; and

(o) all money received because of a settlement agreement or judgment in a lawsuit brought against a manufacturer or distributor of "agent orange" for damages resulting from exposure to "agent orange"; and

(p) except as provided in subsection (9), the difference between the capital gains and losses included in the federal adjusted gross income and the capital gains and losses calculated in [section 1].

(3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted

gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S. election were not in effect.

(4) A shareholder of a DISC that is exempt from the corporation license tax under 15-31-102(1)(l) shall include in his adjusted gross income the earnings and profits of the DISC in the same manner as provided by federal law (section 995, Internal Revenue Code) for all periods for which the DISC election is effective.

(5) A taxpayer who, in determining federal adjusted gross income, has reduced his business deductions by an amount for wages and salaries for which a federal tax credit was elected under section 44B of the Internal Revenue Code of 1954 or as that section may be labeled or amended is allowed to deduct the amount of the wages and salaries paid regardless of the credit taken. The deduction must be made in the year the wages and salaries were used to compute the credit. In the case of a partnership or small business corporation, the deduction must be made to determine the

amount of income or loss of the partnership or small business corporation.

(6) Married taxpayers filing a joint federal return who must include part of their social security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income may split the federal base used in calculation of federal taxable social security benefits or federal taxable tier 1 railroad retirement benefits when they file separate Montana income tax returns. The federal base must be split equally on the Montana return.

(7) A taxpayer receiving retirement disability benefits who has not attained age 65 by the end of the taxable year and who has retired as permanently and totally disabled may exclude from adjusted gross income up to $100 per week received as wages or payments in lieu of wages for a period during which the employee is absent from work due to the disability. If the adjusted gross income before this exclusion and before application of the two-earner married couple deduction exceeds $15,000, the excess reduces the exclusion by an equal amount. This limitation affects the amount of exclusion, but not the taxpayer's eligibility for the exclusion. If eligible, married individuals shall apply the exclusion separately, but the limitation for income exceeding $15,000 is determined with respect to the spouses on their combined adjusted gross income. For the purpose of

this subsection, permanently and totally disabled means unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment lasting or expected to last at least 12 months.

(8) A person receiving benefits described in subsections (2)(d) through (2)(f), (2)(h), or (2)(i) may not exclude benefits described in subsection (2)(c) from adjusted gross income unless the benefits received under subsections (2)(d) through (2)(f), (2)(h), or (2)(i) are less than $3,600, in which case the person may combine benefits to exclude up to a total of $3,600 from adjusted gross income.

(9) The portion of capital loss that is attributable to the adjustment for inflation calculated in [section 1] must be used to offset the inflation-adjusted portion of any capital gain calculated in [section 1] for the taxable period. If for any taxable period beginning after December 31, 1990, the inflation-adjusted capital loss exceeds the inflation-adjusted capital gain, the excess must be a carryforward to each of the five taxable periods following that taxable period to offset any inflation-adjusted capital gain as provided in this subsection. (Subsection (2)(k) terminates on occurrence of contingency--sec. 3, Ch. 634, L. 1983.)"

Section 3. Section 15-30-136, MCA, is amended to read:

"15-30-136. Computation of income of estates or trusts -- exemption. (1) Except as otherwise provided in this chapter, "gross income" of estates or trusts means all income from whatever source derived in the taxable year, including but not limited to the following items:

(a) dividends;

(b) interest received or accrued, including interest received on obligations of another state or territory or a county, municipality, district, or other political subdivision thereof, but excluding interest income from obligations of:

(i) the United States government or the state of Montana;

(ii) a school district; or

(iii) a county, municipality, district, or other political subdivision of the state;

(c) income from partnerships and other fiduciaries;

(d) gross rents and royalties;

(e) gain from sale or exchange of property, including those gains that are excluded from gross income for federal fiduciary income tax purposes by section 641(c) of the Internal Revenue Code of 1954, as amended;

(f) gross profit from trade or business; and

(g) refunds recovered on federal income tax, to the extent the deduction of such tax resulted in a reduction of

LC 0287/01

Montana income tax liability.

(2) In computing net income, there are allowed as deductions:

(a) interest expenses deductible for federal tax purposes according to section 163 of the Internal Revenue Code of 1954, as amended;

(b) taxes paid or accrued within the taxable year, including but not limited to federal income tax, but excluding Montana income tax;

(c) that fiduciary's portion of depreciation or depletion which is deductible for federal tax purposes according to sections 167, 611, and 642 of the Internal Revenue Code of 1954, as amended;

(d) charitable contributions that are deductible for federal tax purposes according to section 642(c) of the Internal Revenue Code of 1954, as amended;

(e) administrative expenses claimed for federal income tax purposes, according to sections 212 and 642(g) of the Internal Revenue Code of 1954, as amended, if such expenses were not claimed as a deduction in the determination of Montana inheritance tax;

(f) losses from fire, storm, shipwreck, or other casualty or from theft, to the extent not compensated for by insurance or otherwise, that are deductible for federal tax purposes according to section 165 of the Internal Revenue

Code of 1954, as amended;

(g) net operating loss deductions allowed for federal income tax under section 642(d) of the Internal Revenue Code of 1954, as amended, except estates may not claim losses that are deductible on the decedent's final return;

(h) all benefits, not in excess of $3,600, received:

(i) as federal employees' retirement;

(ii) as retirement from public employment in a state other than Montana; or

(iii) as an annuity, pension, or endowment under private or corporate retirement plans or systems;

(i) all benefits paid under the Montana teachers' retirement system that are specified as exempt from taxation by 19-4-706;

(j) all benefits paid under the Montana Public Employees' Retirement System Act that are specified as exempt from taxation by 19-3-105;

(k) all benefits paid under the Montana highway patrol officers' retirement system that are specified as exempt from taxation by 19-6-705;

(l) Montana income tax refunds or credits thereof;

(m) all benefits paid under 19-11-602, 19-11-604, and 19-11-605 to retired and disabled firemen or their surviving spouses or children;

(n) all benefits paid under the municipal police

officers' retirement system that are specified as exempt from taxation by 19-9-1005.

(3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202 is not in effect, net income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax net income by reason of the election under subchapter S. However, the shareholder's net income shall include actual distribution from the corporation to the extent it would be treated as taxable dividends if the subchapter S. election were not in effect.

(4) The following additional deductions shall be allowed in deriving taxable income of estates and trusts:

(a) any amount of income for the taxable year currently required to be distributed to beneficiaries for such year;

(b) any other amounts properly paid or credited or required to be distributed for the taxable year;

(c) ~~the--amount--of--60%--of--the--excess--of--the--net long-term--capital-gain-over-the-net-short-term-capital-loss for-the-taxable-year~~ except as provided in subsection (5), the difference between the capital gains and losses included in the federal adjusted gross income and the capital gains and losses calculated in [section 1];

(5) The portion of capital loss that is attributable to the adjustment for inflation calculated in [section 1] must be used to offset the inflation-adjusted portion of any capital gain calculated in [section 1] for the taxable period. If for any taxable period beginning after December 31, 1990, the inflation-adjusted capital loss exceeds the inflation-adjusted capital gain, the excess must be a carryforward to each of the five taxable periods following that taxable period to offset any inflation-adjusted capital gain as provided in this subsection.

~~(5)~~(6) The exemption allowed for estates and trusts is that exemption provided in 15-30-112(2)(a) and 15-30-112(8).

~~(6)~~(7) A trust or estate excluding benefits under subsections (2)(i) through (2)(k), (2)(m), or (2)(n) may not exclude benefits described in subsection (2)(h) from net income unless the benefits received under subsections (2)(i) through (2)(k), (2)(m), or (2)(n) are less than $3,600, in which case the trust or estate may combine benefits to exclude up to a total of $3,600 from net income."

Section 4. Section 15-31-114, MCA, is amended to read:

"15-31-114. Deductions allowed in computing income. In computing the net income, the following deductions shall be allowed from the gross income received by such corporation

within the year from all sources:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in the maintenance and operation of its business and properties, including reasonable allowance for salaries for personal services actually rendered, subject to the limitation hereinafter contained, rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title or in which it has no equity. No deduction shall be allowed for salaries paid upon which the recipient thereof has not paid Montana state income tax; provided, however, that where domestic corporations are taxed on income derived from without the state, salaries of officers paid in connection with securing such income shall be deductible.

(2) (a) All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the wear and tear and obsolescence of property used in the trade or business, such allowance to be determined according to the provisions of section 167 of the Internal Revenue Code in effect with respect to the taxable year. All elections for depreciation shall be the same as the elections made for federal income tax purposes. No deduction shall be allowed for any amount paid out for any buildings, permanent

improvements, or betterments made to increase the value of any property or estate, and no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made. No depreciation or amortization deduction shall be allowed on a title plant as defined in 33-25-105(15).

(b) There shall be allowed as a deduction for the taxable period a net operating loss deduction determined according to the provisions of 15-31-119.

(3) Except as provided in subsection (4), the difference between the capital gains and losses included in the federal adjusted gross income and the capital gains and losses calculated in [section 1];

(4) The portion of capital loss that is attributable to the adjustment for inflation calculated in [section 1] must be used to offset the inflation-adjusted portion of any capital gain calculated in [section 1] for the taxable period. If for any taxable period beginning after December 31, 1990, the inflation-adjusted capital loss exceeds the inflation-adjusted capital gain, the excess must be a carryforward to each of the five taxable periods following that taxable period to offset any inflation-adjusted capital gain as provided in this subsection.

~~(3)~~(5) In the case of mines, other natural deposits, oil and gas wells, and timber, a reasonable allowance for

depletion and for depreciation of improvements; such reasonable allowance to be determined according to the provisions of the Internal Revenue Code in effect for the taxable year. All elections made under the Internal Revenue Code with respect to capitalizing or expensing exploration and development costs and intangible drilling expenses for corporation license tax purposes shall be the same as the elections made for federal income tax purposes.

~~(4)~~(6) The amount of interest paid within the year on its indebtedness incurred in the operation of the business from which its income is derived; but no interest shall be allowed as a deduction if paid on an indebtedness created for the purchase, maintenance, or improvement of property or for the conduct of business unless the income from such property or business would be taxable under this part.

~~(5)~~(7) (a) Taxes paid within the year, except the following:

(i) Taxes imposed by this part.

(ii) Taxes assessed against local benefits of a kind tending to increase the value of the property assessed.

(iii) Taxes on or according to or measured by net income or profits imposed by authority of the government of the United States.

(iv) Taxes imposed by any other state or country upon or measured by net income or profits.

(b) Taxes deductible under this part shall be construed to include taxes imposed by any county, school district, or municipality of this state.

(6) That portion of an energy-related investment allowed as a deduction under 15-32-103.

~~(7)~~ (9) (a) Except as provided in subsection (9)(b), charitable contributions and gifts that qualify for deduction under section 170 of the Internal Revenue Code, as amended.

(b) The public service commission shall not allow in the rate base of a regulated corporation the inclusion of contributions made under this subsection.

~~(8)~~ (10) In lieu of the deduction allowed under subsection ~~(7)~~ (9), the taxpayer may deduct the fair market value, not to exceed 30% of the taxpayer's net income, of a computer or other sophisticated technological equipment or apparatus intended for use with the computer donated to an elementary, secondary, or accredited postsecondary school located in Montana if:

(a) the contribution is made no later than 5 years after the manufacture of the donated property is substantially completed;

(b) the property is not transferred by the donee in exchange for money, other property, or services; and

(c) the taxpayer receives a written statement from the

donee in which the donee agrees to accept the property and representing that the use and disposition of the property will be in accordance with the provisions of (b) of this subsection ~~(8)~~ (10)."

Section 5. Section 15-31-304, MCA, is amended to read:

"**15-31-304. Allocation of nonbusiness income.** (1) Rents and royalties from real or tangible personal property, capital gains as described in [section 1], interest, dividends, or patent or copyright royalties, to the extent that they constitute nonbusiness income, ~~shall~~ must be allocated as provided in subsections (2) through (5) ~~of this section~~.

(2) (a) Net rents and royalties from real property located in this state are allocable to this state.

(b) Net rents and royalties from tangible personal property are allocable to this state:

(i) if and to the extent that the property is utilized in this state; or

(ii) in their entirety if the taxpayer's commercial domicile is in this state and the taxpayer is not organized under the laws of or taxable in the state in which the property is utilized.

(c) The extent of utilization of tangible personal property in a state is determined by multiplying the rents and royalties by a fraction the numerator of which is the number of days of physical location of the property in the state during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the state in which the property was located at the time the rental or royalty payer obtained possession.

(3) (a) Capital gains and losses, as described in [section 1], from sales of real property located in this state are allocable to this state.

(b) Capital gains and losses, as described in [section 1], from sales of tangible personal property are allocable to this state if:

(i) the property had a situs in this state at the time of the sale; or

(ii) the taxpayer's commercial domicile is in this state and the taxpayer is not taxable in the state in which the property had a situs.

(c) Capital gains and losses, as described in [section 1], from sales of intangible personal property are allocable to this state if the taxpayer's commercial domicile is in this state.

(4) Interest and dividends are allocable to this state if the taxpayer's commercial domicile is in this state.

(5) (a) Patent and copyright royalties are allocable to this state if and to the extent that:

(i) the patent or copyright is utilized by the payer in this state; or

(ii) the patent or copyright is utilized by the payer in a state in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this state.

(b) A patent is utilized in a state to the extent that it is employed in production, fabrication, manufacturing, or other processing in the state or to the extent that a patented product is produced in the state. If the basis of receipts from patent royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the patent is utilized in the state in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a state to the extent that printing or other publication originates in the state. If the basis of receipts from copyright royalties does not permit allocation to states or if the accounting procedures do not reflect states of utilization, the copyright is utilized in the state in which the taxpayer's commercial domicile is located."

NEW SECTION. **Section 6.** Codification instruction.

[Section 1] is intended to be codified as an integral part of Title 15, chapter 30, part 1, and the provisions of Title 15, chapter 30, part 1, apply to [section 1].

NEW SECTION. **Section 7. Retroactive applicability.** [This act] applies retroactively, within the meaning of 1-2-109, to taxable years beginning after December 31, 1990.

NEW SECTION. **Section 8. Effective date.** [This act] is effective on passage and approval.

-End-

STATE OF MONTANA - FISCAL NOTE
Form BD-15
In compliance with a written request, there is hereby submitted a Fiscal Note for HB0447 , as introduced.

DESCRIPTION OF PROPOSED LEGISLATION:

An act revising certain provisions relating to the taxation of the income of individuals and corporations; allowing the application of an inflation factor to capital gains or losses for the purposes of taxation; extending the exclusion of interest income to all individuals; increasing the exclusion of interest income; allowing the application of an inflation factor to interest income; and providing an immediate effective date and a retroactive applicability date.

ASSUMPTIONS:

1. Individual income tax collections under current law are $311,176,000 in FY92 and $327,201,000 in FY93 (OBPP).
2. The proposed base year (1980) interest exclusion of $960, when adjusted for the inflation factor in current law, produces an interest exclusion of up to $1,510 ($3,020 if filing joint) in tax year 1991 (the first year in which the new exclusion would be allowed).
3. Providing the increased interest exclusion to all filers reduces revenue $8,756,000 in FY92, and $9,632,000 in FY93 (DOR income tax simulations).
4. The indexing provisions relating to capital gains apply to assets "purchased and sold" after December 31, 1990; consequently, there is no revenue impact from this part of the proposal in FY92.
5. Based on IRS estimates of holding period distributions of securities, and actual 1988 capital gains reported on Montana individual income tax returns, this proposal is estimated to reduce individual income tax revenue $428,000 in FY93.
6. The absence of relevant data precludes an estimate of the impact of the capital gains indexing provisions of this proposal on corporation license tax revenue.
7. This bill applies to taxable years beginning after December 31, 1990.
8. Under current law, all revenue from the individual income tax is deposited in the state general fund in FY92 and FY93.
9. The proposal would require computer program development costs of $19,080 and additional annual operating costs of $3,570.

FISCAL IMPACT:

see next page

2-4-91
ROD SUNDSTED, BUDGET DIRECTOR DATE
Office of Budget and Program Planning

John Cobb 2-5-91
JOHN COBB, PRIMARY SPONSOR DATE

FISCAL IMPACT:

Expenditures:

	FY '92			FY '93		
	Current Law	Proposed Law	Difference	Current Law	Proposed Law	Difference
F.T.E.	0	0.33	0.33	0	0.05	0.05
Personal Services	0	17,080	17,080	0	2,800	2,800
Operating Expense	0	5,570	5,570	0	770	770
Total	0	22,650	22,650	0	3,570	3,570
Funding:						
General Fund	0	22,650	22,650	0	3,570	3,570

Revenues:

Individual Income Tax (General Fund)	311,176,000	302,420,000	(8,756,000)	327,201,000	317,141,000	(10,060,000)

LONG-RANGE EFFECTS OF PROPOSED LEGISLATION:

Given that some capital assets may be held for as long as 30 years, it will take that amount of time for this proposal to be fully phased in. Had this proposal been in effect for the past thirty years, it is estimated that calendar year 1989 tax liabilities would have been reduced $10-12 million.

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