



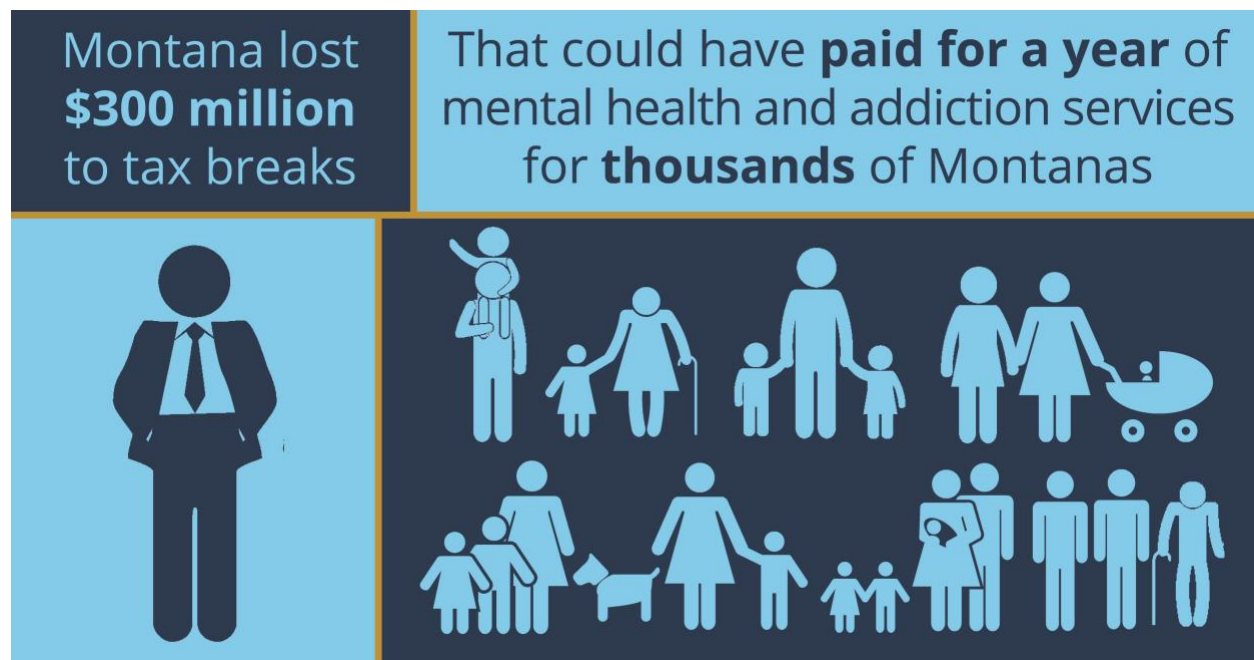
## Where Is the Money Going? It Is Time to Look at Montana's Tax Expenditures

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All Montanans want a state of which we can be proud, one where our children can learn, grow, prosper, and stay to raise their own families. That future depends on our ability to invest in the public structures that educate our children, keep our communities safe, protect our land and water, and provide health care and other services for Montanans struggling to make ends meet.

Montana deserves a sensible approach to our revenue challenges that looks both at how budget cuts hurt families and communities and at how common sense revenue reforms will generate the resources we need to sustain our state.

Each session, the Legislature is tasked with balancing the state budget. One solution for maintaining our investments in education, health care, and other public services is to scrutinize tax expenditures to determine if any are obsolete, ineffective, or need to be updated to reflect the current economy. Tax expenditures are tax breaks that, just like appropriations, cost the state millions of dollars in revenue every year. In the last full year with available data, Montana lost around \$300 million, which amounted to 12 percent of the state's general fund revenue in fiscal year 2018. These resources could have funded an entire year of operations of the Addiction and Mental Disorders division in the Department of Public Health and Human Services,<sup>1</sup> helping thousands of Montanans each year. As the Legislature looks to maintain investments in the things that protect and strengthen communities such as affordable housing, schools, and public health, they should consider eliminating inefficient and costly tax breaks.



## What are Tax Expenditures?

Tax expenditures are often described as “silent spending.” They come in the form of preferences such as tax deductions, exemptions, deferrals, exclusions, credits, or lower tax rates given to individuals or businesses. Tax expenditures are a form of spending because they allocate funds for specific public purposes, although not through direct appropriations.

They have a significant impact on state revenue as they reduce or eliminate revenue that would have otherwise been collected. These expenditures are commonly referred to as incentives. Tax exemptions are not inherently good or bad policy. However, just like other state spending, evaluating them on a regular basis is a strategy for making sure that public resources can have the biggest impact.

## Tax Expenditures in Montana

In Montana, all the major tax types have tax expenditures. The table below details the amount by the type of tax. Personal income tax expenditures account for 80 percent of the state’s tax expenditures.

One of the largest individual income tax expenditures is the capital gains tax credit, which cost the state over \$48 million in 2017. This tax preference allows investors to pay a lower tax rate on income from investments than other types of income.

The largest corporate income tax expenditure is the water’s edge election, which cost the state around \$10 million in 2016. The water’s edge election allows multinational corporations to avoid paying taxes on profits they shifted overseas while our main street businesses have to pay taxes on all of their earnings.

Tax Type	Expenditure	Count
Personal Income	\$234,596,442	49
Corporate Income	\$9,112,201	24
Natural Resources	\$3,976,584	6
Property	\$45,310,845	8
Total	\$292,109,869	87

One of the largest property tax exemptions is the intangible personal property exemption, which cost the state over \$15 million in 2018 and resulted in a tax shift of \$80 million of taxes to other taxpayers, increasing taxes on homeowners and small businesses. This provision allows some of Montana’s biggest corporations to avoid paying property taxes on some types of property.

## Tax Credits

A tax credit is one type of tax expenditure. A tax credit is an amount of money that taxpayers can subtract from taxes owed. Because a tax credit directly reduces total taxes owed, this type of tax exemption can be costly to the state in lost revenue. It is often difficult for states to estimate the future cost of tax credits, and tax credits enacted without caps can often cost far more than projected.<sup>2</sup> The capital gains tax credit, for example, was estimated to cost the state about \$8 million a year, but it actually cost the state \$16 million when it was fully phased in in 2005 and has increased to cost the state almost \$48 million in 2017.<sup>3</sup>

Tax credits can be structured to be refundable or nonrefundable. With a refundable credit, if the credit reduces the tax bill by more than the taxpayer owes, they can receive a refund. However, a nonrefundable credit can only reduce taxes owed to zero. Because of this, nonrefundable credits are much less beneficial to families living on low- and middle-incomes than families with high-incomes. Tax credits that are structured to be nonrefundable, meaning a taxpayer must earn enough to owe income tax in order to take the credit, are of little use to working families with less income tax liability (but likely paying other types of taxes, such as payroll, property, and excise taxes). In 2017, 62.4 percent of income tax credits claimed by residents went to households making over \$204,501 in annual income.<sup>4</sup>

**In the first year, the capital gains tax credit cost the state more than double what the Legislature estimated. In 2017, the credit cost \$48 million.**

The table at the end of the report shows all individual income and corporate income tax credits.

## **Deductions, Exemptions, Exclusions, and other Tax Preferences**

In addition to tax credits, tax expenditures come in the form of special treatment for types of income through exemptions or exclusions from taxable income, itemized deductions, and lower tax rates for certain types of income. Some of these tax expenditures are a result of following the federal law and tying to federal adjusted gross income, but states can choose to stop complying with provisions in the federal tax code. Other tax expenditures are a result of decisions the state Legislature makes with regard to what types of income should receive preferential tax treatment.

Over half (58 percent) of personal income tax expenditures and 88 percent of corporate income tax expenditures in the past year were deductions, exemptions, exclusions, or other tax preferences. Table 2 (page 5,6) shows all deductions, exemptions, and exclusions for the last full complete year, by tax type.

## **A Model for Tax Expenditure Reporting**

House Bill 723, passed by the 2019 Legislature, asks the Revenue Interim Committee to review all tax credits over the course of the next 10 years. While HB 723 is a step in the right direction of providing accountability for these revenue reducers, it includes only tax credits, and does not provide sunset dates for each credit, reducing the incentive for the Legislature to conduct a thorough review.

The first step in evaluating tax expenditures is the creation of a report that allows policymakers to analyze how much tax expenditures are costing the state, who is benefiting, and which expenditures are serving their purpose.

A high-quality state tax expenditure report should be:

- **Accessible** - Not only should the report be easy to access and use, it should actually be used to determine tax expenditure effectiveness. The report should be published regularly, incorporated into the budget process, and accessible online.
- **Comprehensive** - Most or all tax expenditures should be included in such a report, including implicit expenditures.
- **Detailed** - The report should include the precise cost to the state, a description of the expenditure (including the legal citation and the year enacted), the number and description of taxpayers benefiting, cost projections for comparison with other expenditures, and separate reporting for any expenditure that impacts both state and local revenues.

- **Analytical** - The report should detail whether the expenditure is meeting the goals intended by the Legislature and should be classified by function, state the purpose of the expenditure, and include an analysis of who benefits.

Our state is one of 44 (including the District of Columbia) that produce a tax expenditure report. Montana's report includes most of the elements mentioned above. However, improvements could be made by listing the rationale for each expenditure and projecting future costs of expenditures.

Currently, the Montana Department of Revenue's tax expenditure report is one of the most thorough in the nation, but many of the components of the report are voluntarily included by the Department.<sup>6</sup> Policymakers could ensure the ongoing production of this useful information by requiring that the report and its current components be created each biennium.

## Recommendations for Informed Decisions on Tax Expenditures

To make decisions about the state budget more accountable and transparent, tax expenditures must face the same scrutiny that other state spending faces. In addition to the tax expenditure report, policymakers could improve accountability in this area by:

- Automatically sunseting all tax expenditures on a rolling basis (with a set number of credits scheduled to sunset each biennium);
- Requiring that the governor make explicit recommendations on every reviewed tax expenditure in their budget proposal; and
- Requiring that any piece of legislation enacting or expanding a tax expenditure include a statement of its purpose, a discussion of data/performance indicators that should be used to evaluate its success, and an explanation of why this purpose is being pursued via the tax code (i.e. why use a tax expenditure rather than a direct spending program?).

## Conclusion

State spending in virtually every other area is held under a microscope every legislative session. Having these public discussions about state spending adds to the transparency and accountability of our democratic system. HB 723 is a good start to evaluating tax credits, but it is not enough. For the state to be accountable to its residents, all tax expenditures should automatically sunset on a rolling basis and thoroughly evaluated.



**Table 1. Individual Income and Corporate Income Tax Credits**

Credit	Number	Amount	Year	Tax Type
Special Treatment for Capital Gains	72,881	\$48,144,173	TY 2017	Individual Income Tax
Credit for Other States' Taxes	14,070	\$33,984,000	TY 2017	Individual Income Tax
Elderly Homeowner/Renter Credit	13,567	\$6,955,393	TY 2017	Individual Income Tax
Energy Conservation Credit	7,266	\$3,484,878	TY 2017	Individual Income Tax
Qualified Endowment Credit	728	\$2,981,018	TY 2017	Individual Income Tax
Infrastructure Users Fee Credit	21	\$1,457,532	TY 2017	Individual Income Tax
College Contribution Credit	3,089	\$350,872	TY 2017	Individual Income Tax
Alternative Energy Systems Credit	742	\$315,904	TY 2017	Individual Income Tax
Recycling Credit	106	\$283,047	TY 2017	Individual Income Tax
Adoption Credit	175	\$169,555	TY 2017	Individual Income Tax
Geothermal Heating System Credit	91	\$135,223	TY 2017	Individual Income Tax
Health Insurance for Uninsured Montanans Credit	52	\$47,564	TY 2017	Individual Income Tax
Alternative Energy Production Credit	*	\$29,765	TY 2017	Individual Income Tax
Historic Property Preservation Credit	13	\$29,281	TY 2017	Individual Income Tax
Student Scholarship Organization Credit	123	\$26,270	TY 2017	Individual Income Tax
Elderly Care Credit	57	\$24,893	TY 2017	Individual Income Tax
Temporary Emergency Lodging Credit	20	\$10,051	TY 2017	Individual Income Tax
Innovative Education Credit	39	\$8,572	TY 2017	Individual Income Tax
Dependent Care Assistance Credit	*	\$7,215	TY 2017	Individual Income Tax
Alternative Fuel Credit	12	\$3,129	TY 2017	Individual Income Tax
Research Credit	*	\$3,068	TY 2017	Individual Income Tax
Mineral Exploration Credit	*	\$2,020	TY 2017	Individual Income Tax
Unlocking State Lands Credit	*	\$1,973	TY 2017	Individual Income Tax
Empowerment Zone Credit	0	\$0	TY 2017	Individual Income Tax
Biodiesel Credits	0	\$0	TY 2017	Individual Income Tax
Apprenticeship Tax Credit	N/A	N/A	N/A	Individual Income Tax
Earned Income Tax Credit	N/A	N/A	N/A	Individual Income Tax
Infrastructure Users Fee Credit	*	\$706,524	TY 2016	Corporate Income Tax
Contractor's Gross Receipts Credit	88	\$319,316	TY 2016	Corporate Income Tax
Historic Property Preservation Credit	*	\$39,653	TY 2016	Corporate Income Tax
Charitable Endowment Credit	11	\$25,130	TY 2016	Corporate Income Tax
Recycling Credit	*	\$7,605	TY 2016	Corporate Income Tax
College Contribution Credit	25	\$4,898	TY 2016	Corporate Income Tax
New/Expanded Industry Credit	*	\$872	TY 2016	Corporate Income Tax
Health Insurance for Uninsured Montanans Credit	*	\$350	TY 2016	Corporate Income Tax
Qualified Research Credit	*	\$223	TY 2016	Corporate Income Tax
Mineral Exploration Credit	*	\$25	TY 2016	Corporate Income Tax
Alternative Energy Production Credit	0	\$0	TY 2016	Corporate Income Tax
Alternative Fuel Motor Vehicle Conversion Credit	0	\$0	TY 2016	Corporate Income Tax
Biodiesel Blending and Storage Tank Credit	0	\$0	TY 2016	Corporate Income Tax
Dependent Care Assistance Credit	0	\$0	TY 2016	Corporate Income Tax
Empowerment Zone New Employees Tax Credit	0	\$0	TY 2016	Corporate Income Tax
Geothermal Heating System Credit	0	\$0	TY 2016	Corporate Income Tax
Oilseed Crushing & Biodiesel Production Credit	0	\$0	TY 2016	Corporate Income Tax
Short-Term Temporary Lodging Credit	0	\$0	TY 2016	Corporate Income Tax
Apprenticeship Tax Credit	N/A	N/A	N/A	Corporate Income Tax

**Table 2. Tax Exemptions, Exclusions, Deductions, and Other Tax Preferences**

Tax Expenditure	Number	Amount	Year	Tax Type
Federal Income Tax Deduction	242,699	\$74,238,304	TY 2017	Individual Income Tax
Special Treatment for Capital Gains	72,881	\$48,144,173	TY 2017	Individual Income Tax
Medical Insurance Premium Deduction	103,991	\$22,600,177	TY 2017	Individual Income Tax
Medical and Dental Expenses Deduction	60,310	\$11,795,070	TY 2017	Individual Income Tax
Exempt Military Salary	4,759	\$9,059,626	TY 2017	Individual Income Tax
Unemployment Compensation Deduction	21,741	\$5,072,028	TY 2017	Individual Income Tax
Partial Pension Exemption	44,862	\$3,965,750	TY 2017	Individual Income Tax
Exempt Tips	20,718	\$3,861,857	TY 2017	Individual Income Tax
Long Term Care Insurance Premium Deduction	10,451	\$1,627,086	TY 2017	Individual Income Tax
Partial Interest Exclusion for Elderly Taxpayers	69,725	\$1,569,092	TY 2017	Individual Income Tax
Montana Medical Care Savings Account Deduction	6,101	\$1,157,835	TY 2017	Individual Income Tax
Family Education Savings Account Deduction	3,807	\$832,099	TY 2017	Individual Income Tax
Third-Party Repayment of Health Care Professional's Student Loan Deduction	455	\$91,905	TY 2017	Individual Income Tax
Small Business Investment Company Dividend Deduction	*	\$79,110	TY 2017	Individual Income Tax
Political Contribution Deduction	6,832	\$49,728	TY 2017	Individual Income Tax
First Time Homebuyer Account Deduction	217	\$43,658	TY 2017	Individual Income Tax
Health Benefits Limited to Highly-Compensated Employees Deduction	155	\$38,671	TY 2017	Individual Income Tax
Worker's Compensation Deduction	155	\$28,841	TY 2017	Individual Income Tax
Business Purchases of Recycled Material Deduction	90	\$13,425	TY 2017	Individual Income Tax
Child and Dependent Care Expenses Deduction	496	\$5,321	TY 2017	Individual Income Tax
ABLE Account Deduction	35	\$4,244	TY 2017	Individual Income Tax
Partial Exclusion of Capital Gains on Pre-1987 Installment Sales	12	\$3,291	TY 2017	Individual Income Tax
Exempt Disability Retirement Income Deduction	37	\$2,408	TY 2017	Individual Income Tax
National Guard Life Insurance Premiums Deduction	28	\$1,325	TY 2017	Individual Income Tax
Sales of Land to Beginning Farmers Deduction	*	\$195	TY 2017	Individual Income Tax
Water's Edge Election	487	\$8,000,000	TY 2016	Corporate Income Tax
Recycled Material Qualifying for Deduction	*	\$7,605	TY 2016	Corporate Income Tax
Capital Gain Exclusion for Mobile Home Park	-	-	TY 2016	Corporate Income Tax
Deduction for Donation of Exploration Information	-	-	TY 2016	Corporate Income Tax
Deduction for Purchasing Montana-Produced Organic Fertilizer and Inorganic Fertilizer	-	-	TY 2016	Corporate Income Tax
Energy Conserving Investments Deduction	-	-	TY 2016	Corporate Income Tax
Generally Exempt Property	N/A	\$20,803,542	TY 2018	Property Tax
Intangible Personal Property Exemption	171	\$15,595,004	TY 2018	Property Tax
Tax Increment Financing Districts	N/A	\$5,258,806	TY 2018	Property Tax
Property Tax Assistance Program	23,018	\$2,589,060	TY 2018	Property Tax
Disabled American Veterans Program	2,567	\$647,417	TY 2018	Property Tax
Energy Production or Development Tax Abatement	N/A	\$357,107	TY 2018	Property Tax
Land Value Property Tax Assistance Program	104	\$59,909	TY 2018	Property Tax
Electrical Generation and Transmission Facility Exemption	0	\$0	TY 2018	Property Tax
Oil New Production Holiday	28	\$2,537,259	TY 2018	Natural Resources
Oil Stripper Well Production	1,295	\$945,954	TY 2018	Natural Resources
Natural Gas Pre-1999 and Less than 60 MCF/day	4,507	\$362,249	TY 2018	Natural Resources
Natural Gas New Production Tax Holiday	21	\$131,122	TY 2018	Natural Resources
Oil Horizontally Recompleted Wells	0	\$0	TY 2018	Natural Resources
Reduced Gross Proceeds Tax Rate for New Underground Mines	0	\$0	TY 2018	Natural Resources

"- Indicates the tax provision was not claimed in the last year."

"\* Indicates there were 10 or fewer claims of the tax provision in the last year."

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- <sup>1</sup> Governor's Office of Budget and Program Planning, "[2021 Biennium Executive Budget](#)," Nov. 15, 2018.
- <sup>2</sup> Institute on Taxation and Economic Policy, "[Tax Expenditures: Spending by Another Name](#)," Oct. 2011.
- <sup>3</sup> Dodds, D., Department of Revenue, memo to the Senate Taxation Committee, "[Information Requested](#)," Mar. 24, 2011.
- <sup>4</sup> Montana Department of Revenue, "[Biennial Report July 1, 2016 – June 30, 2018](#)," Dec. 17, 2018.
- <sup>5</sup> Leachman, M, Grundman, D, and Johnson, N, "[Promoting State Budget Accountability Through Tax Expenditure Reporting](#)," May 24, 2011.
- <sup>6</sup> Montana Code Annotated 15-1-205(3).