



Presentation to the Montana Chamber of Commerce 2018 Annual Meeting

Assessing Montana's Business Tax Structure: Competitiveness and Revenue Effects of Possible Broader Tax Reforms

October 26, 2018

Agenda

- Business Taxation in Montana
- Competitiveness Analysis
- Tax Reform Options
 - Property Tax Reform Modeling
 - Consumption Tax Reform Modeling

Montana's Current Business Tax Structure

MT's Total and Business Tax Composition

Type of taxes	All taxes		Business taxes	
	Montana	U.S.	Montana	U.S.
Property taxes	39%	31%	51%	38%
Sales taxes	0%	22%	0%	21%
Excise taxes, including public utilities and insurance	14%	11%	12%	12%
Corporate income taxes	3%	4%	6%	9%
Unemployment insurance taxes	3%	3%	7%	6%
Individual income taxes (on business income)	29%	23%	7%	6%
Licenses and other taxes, including severance taxes	13%	7%	18%	8%
Total taxes	100%	100%	100%	100%

- Lack of consumption tax puts extra stress on other taxes

MT's Business Tax Competitiveness

Business Taxes, Montana Compared to U.S. Average

	Montana	U.S. Average	Montana as % of U.S.
Business share of taxes			
State taxes	41%	39%	107%
Local taxes	63%	52%	122%
Total S&L taxes	48%	44%	110%
Local share of total business taxes	45%	48%	94%
Property tax share of S&L business taxes	51%	38%	132%
Total effective business tax rate	5.1%	4.5%	113%

Source: COST/EY *Total Business Tax Study* (August 2017)

- *MT effective business tax rate is 12th highest in U.S.*

Effects of Montana's Business Tax Structure

- Montana's total effective tax rate on business income is 5.1% is 13% higher than the US average of 4.5%
- Montana's tax is organized in a way that weighs heavily on capital investments and new businesses
- High business property taxes, corporate income taxes as well as a relatively high overall business tax rate make it harder to make capital investments in Montana

Analysis of the Competitiveness of Montana's Business Taxes

STRI analysis of the competitiveness of Montana's business taxes

- Compares Montana's existing business tax structure for six selected industries with six competitor states
- Identifies "sore thumbs" where Montana's business tax structure is putting its domestic companies at a cost disadvantage to similar companies based in competitive states
- The competitiveness model can be used to simulate changes in Montana's business tax competitiveness under alternative tax reform proposals

Competitor states and industries modeled

Competitor states

- Colorado
- Idaho
- North Dakota
- Utah
- Washington
- Wyoming

Industries

- Small pass-through manufacturer
- Metal fabrication
- Food & beverage retail
- Credit card processor
- Wholesale drug distributor
- Data processing (information services)

Property tax effective tax rates for Montana and competitor states

Competitor states	Industrial rate	Commercial rate
Colorado	1.86%	2.31%
Idaho	1.17%	1.42%
North Dakota	0.58%	0.96%
Utah	1.12%	1.39%
Washington	0.69%	0.85%
Wyoming	0.66%	0.61%
Montana*	1.15-1.76%	1.18-1.21%

*Rates vary due to progressive class rates.

MT income tax: relatively high rates and taxes on in-state business activity

Competitor states	Individual income tax rate (percent)	Corporate income tax rate (percent)	Apportionment (prop/payroll/sale)
Colorado	4.63	4.63	0/0/100%
Idaho	7.4	6.925	25/25/50%
North Dakota	2.9	4.3	0/0/100%
Utah	4.95	4.95	25/25/50%*
Washington	na	na	na
Wyoming	na	na	na
Montana	6.9	6.75	33/33/33%

*Some industries have 33/33/33%

General sales tax features for Montana and competitor states

Competitor states	State rate (percent)	Local effective rate (percent)	Combined rate (percent)
Colorado	2.9	3.9	6.8
Idaho	6.0	0.0	6.0
North Dakota	5.0	0.8	5.8
Utah	4.7	1.9	6.6
Washington	6.5	1.6	8.1
Wyoming	4.0	1.2	5.2
Montana	0.0	0.0	0.0

Note: Washington rate does not include the B&O gross receipts tax

Montana total business tax relative to competitor states

Competitor states	Small Manufact.	Metal Fabricator	Food & Bev. Retail	Credit Card Processor	Drug Whole. Dist.	Data Processing
Colorado	87%	125%	54%	231%	102%	80%
Idaho	84%	131%	87%	115%	90%	94%
North Dakota	139%	241%	119%	299%	145%	120%
Utah	91%	135%	76%	128%	77%	77%
Washington	69%	113%	47%	137%	62%	60%
Wyoming	142%	250%	96%	425%	160%	121%

State/industry in red indicate Montana taxes higher than competitor states

Percentage is Montana tax divided by competitor state tax. For example, Montana's tax is 87% of Colorado's tax for a small manufacturer, or 13% lower. Montana's tax is 125% of the tax on a Colorado metal fabricator, or 25% higher.

Observations from competitiveness analysis

- Montana is not competitive on business income taxes (high corporate and personal tax rates and unfavorable apportionment)
- Montana is not competitive with high-tiered property tax rates
- Montana has some capacity to substitute higher business taxes on consumption in order to lower non-competitive business taxes

Some Tax Reform Options

Tax Reform Options

- Incremental tax reforms
 - Business equipment tax relief
 - Compliance and administrative issues
 - Corporate income tax improvements, such as lower rate, 100% destination sales apportionment, repeal tax haven black list
- Broader reform options to reduce income and property taxes
 - Equalize business and residential property tax rates
 - Retail sales tax
 - Business entity level tax on consumption

Broader Tax Reform Options

- Broader tax reform options could:
 - Reduce burden on new investment within the state
 - Collect additional tax from out-of-state purchasers
 - Increase uniformity in business taxes across business-entity types
- STRI asked to estimate the potential revenue implications of broader tax reform options
 - Options could then be evaluated in terms of effect on competitiveness

Initial Modeling of Property Tax Reforms

Modeling Two Property Tax Reforms

- Repeal business personal property tax
- Equalize property tax class rates, for both real and personal property at residential property class rates
 - Residential property currently taxed at 1.35%
 - Business property class rates up to 3%; utility personal property tax rates up to 12%

Revenue change from repealing business personal property taxes

- Eliminating business and utility personal property taxes would reduce property tax revenues by \$235 million a year (at 2016 levels)
 - A 33% reduction in business property taxes
 - A 15% reduction in total property taxes

Revenue change from equalizing property tax rates

Equalize Business and Residential Class Tax Rates (dollars in millions)

Business property	Current	Proposed	Change in Taxes	
	Taxes	Taxes	Amount	Percent
Commercial land	68	48	-20	-29%
Commercial improvements	173	124	-49	-28%
Business personal	87	55	-32	-37%
Total non-utilities	328	228	-100	-31%
Utilities				
Real	65	14	-51	-79%
Personal	148	26	-122	-83%
Mileage	175	37	-138	-79%
Total utilities	388	76	-311	-80%
Total business property taxes	716	304	-412	-57%

Note: Proposed change imposes a 1.35% class tax rate on all business property.

Revenue change from equalizing property tax rates

- Equalizing the rates would set all class rates at 1.35% resulting in an annual revenue loss of \$412 million (at 2016 levels)
 - 57% of business property tax
 - 27% of total property tax
- Revenue loss (with equalization) for non-utility businesses would be \$100 million
 - 31% of non-utility business property tax
 - 6% of total property tax

Preliminary estimates of two consumption tax options

Retail Sales Tax

- STRI has completed preliminary estimates of the potential base and tax revenue from adopting a retail sales tax modeled on the sales tax features of a typical state sales tax
- The modeled sales tax system has:
 - A broad base including most consumer product purchases, but excluding most business purchases
 - Exemption for most purchases of services, except for utility purchases by households
 - Exemption of sales to non-profits and government
 - Motor vehicles are taxable; housing is exempt
 - Exempts motor fuels, tobacco and alcohol purchases

Preliminary Sales Tax Estimates

Montana Sales Tax Base and Revenue at 4% Tax Rate

Tax Base Categories	Base (\$1,000s)	Percent Distribution	Tax Revenue
1. Tax on household purchases	14,578,771	66%	583,151
2. Tax on capital purchases	1,571,764	7%	62,871
3. Tax on intermediate business inputs	5,998,953	27%	239,958
Total tax base	22,149,488	100%	885,980

- Only 36% of total consumer expenditures (products and services) are included in the sales tax base
- Sales taxes on business inputs are \$303 million
- Business share of the estimated sales taxes is 34%

Consumption-Based Business Activity Tax (BAT) Assessed at Entity Level

- Value-added (consumption) base equals:
 - Firms' total sales minus business input purchases, including all capital purchases.
 - Equivalently, base equals sum of payments to factors of production: capital and labor
- Includes all forms of doing business: corporations and pass-through entities
- Apportioned by 100% destination sales factor:
 - Excludes value added on exports
 - Includes value added on imports

Potential Montana BAT Base and Annual Tax Revenue

Amounts in millions of dollars	Comprehensive BAT base	"Typical" BAT base with selected exclusions
	\$29,790	\$21,861
Tax rates	Tax Revenue	Tax Revenue
0.25%	74	55
0.50%	149	109
0.75%	223	164
1.00%	298	219
1.25%	372	273
1.50%	447	328
1.75%	521	383
2.00%	596	437
Revenue per 1/10 of 1% tax rate	\$30	\$22

Preliminary BAT Results

- A comprehensive BAT would raise an estimated \$298 million at a 1.0% rate
- The exclusions from the base for the typical BAT would reduce the tax base by 27%
- The typical BAT base would raise \$219 million at a 1% rate
- Retail sales tax rates are generally much higher than current BAT rates of 0.75-2.0%

Comparing the Retail Sales Tax and BAT Estimates

- The sales tax base includes a smaller percentage of consumer spending compared to a typical BAT base: 36% vs. 73%
- The sales tax base includes significantly more business inputs compared to a BAT
 - Under an entity level BAT, there would be no taxable business-to-business sales

Potential next steps

- Determine package of tax reform proposals, including revenue targets
- Model competitive impacts and revenue effects of alternative tax reform proposals

Questions?

- This presentation has been intended to stimulate discussion about the state of taxation in Montana, where it needs to go, and what the business community can do to move that process along.