MBPC Montana Budget & Policy Center

Fact Sheet
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Restoring Revenue and Fairness
HB395: New Top Marginal Rate for Taxable Income

The 61st Legislature is faced with the unenviable challenge of balancing the budget during a time of economic downturn and revenue uncertainty. Introducing a new top marginal tax rate for households with incomes over $250,000 will offer fiscal security for Montana while restoring some of the progressivity of the Montana income tax system. It will also allow the Legislature to move closer to the revenue and distributional outcome originally anticipated when passing Senate Bill 407 during the 2003 Legislative Session.

Senate Bill 407 was More Expensive and Less Fair than Predicted at Passage.
At the time of passage, Senate Bill 407 was anticipated to cost the state of Montana $26 million in decreased revenue for tax year 2005. The Department of Revenue has reported that the actual cost was over $100 million.

Furthermore, the tax relief provided by Senate Bill 407 was not distributed evenly across all income groups. Higher-income households received substantially more of the relief, and lower-income households received less of the relief, than had been predicted in 2003:

- Montana households making less than $65,000 (81% of all households) received just 7.2% of the total tax liability reduction, with an average tax reduction of $23 per household.
- Montanans with incomes between $60,000 and $75,000 receive tax increases of more than $50.
- Montana households with incomes over $500,000 (.4% of all households) received almost half of the total tax liability reduction, with an average tax reduction of $30,499.

Major Provisions of SB 407

- Reduced the number of tax brackets from 10 to 6
- Lowered the top bracket rate from 11% to 6.9%
- Reduced the income at which the top rate is effective from $82,400 to $13,900.
- Reduced effective rates on capital gains by giving a nonrefundable credit on capital gains of 1% in 2006 and 2007and 2% starting in 2008.
- Capped the allowable itemized deduction for federal income taxes at $5000 for single and $10,000 for married filing joint.

 p. 406.422.7320 *f.* 406.449.0602 *e.* tveazey@montanabudget.org *a.* 910 E. Lyndale, Ste. A, Helena, MT 59601

House Bill 395 would Help Reverse Some of the Unintended Consequences of Senate Bill 407.
By restoring one additional tax bracket with a tax rate that is still lower than the top tax rate prior to SB 407, House Bill 395 would bring our income tax system closer to the outcome originally anticipated by the 2003 Legislature.

Only 1% (or less) of Montana Households will be Affected by HB395.
Somewhere between .4% and 1% of Montana households have an income high enough to be effect by HB 395.[1, 2] While the bill creates the new bracket starting at $250,000, that amount will be adjusted for inflation (like all the brackets are) and will actually be closer to $300,000 for its first effective year. (The brackets represent the law in 2005 and are adjusted for inflation each year.)

Taxes on These Households will not Increase by the Total Amount of the Fiscal Note.
Twenty-five percent of the increase in state taxes will be offset by a reduction in federal taxes.[1] State taxes are deductible for those who itemize on their federal income taxes. Therefore, any increase in state taxes is partially offset by a decrease in federal taxes. The offset is larger when a higher percentage of those affected by the increase are itemizers, thus tax increases for those in the highest income brackets have the largest federal offset. 93% of Montana taxpayers with over $200,000 income itemize.[2]

Tax Increases During Economic Downturns
Economists across the country recognize that tax increases on high-income taxpayers are preferable to spending cuts in economic downturns. Peter Orszag, former director of the Congressional Budget Office (under President George W. Bush) and nominee for director of the Office of Management and Budget (under President Barack Obama), and Joseph Stiglitz, Nobel Prize winner in Economics and professor at Columbia University, wrote

> *" [T]ax increases on higher-income families are the least damaging mechanism for closing state fiscal deficits in the short run. Reductions in government spending on goods and services, or reduction in transfer payments to lower-income families, are likely to be more damaging to the economy in he short run than tax increases focused on higher-income families."[4]*

One hundred and twenty economists recently cosigned a letter to the New York Governor reiterating the point made by Orszag and Stiglitz.

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