

OFFICE OF THE GOVERNOR
STATE OF MONTANA



STEVE BULLOCK
GOVERNOR

MIKE COONEY
LT GOVERNOR

To: Governor Bullock

From: Dan Villa, Budget Director

A blue ink signature of Dan Villa, Budget Director.

Date: 1/18/2018

RE: General Fund Impacts of Federal Tax Legislation

The Department of Revenue has completed its analysis of federal tax law changes passed by Congress in December 2017. The Revenue Team in the Office of Budget and Program Planning has reviewed the Department's work and advised me of the fiscal year implications. I concur with current findings and have applied the adjustments to the general fund balance sheet used during the November Special Session to reflect new federal tax policy.

While revenue losses are real, they are not significant enough in nature to necessitate implementation of 17-7-140, MCA reductions nor a special session at this time.

Analysis dated January 17, 2018 reflect the impacts on general fund revenues. Losses to both corporate and insurance premium revenues will be partially offset by increases in Montana individual income tax caused by the federal legislation. The net impact to the general fund is anticipated to be a loss of \$19.9 million for the 2019 biennium.

I have attached an updated general fund balance sheet reflecting federal legislative action as well as memos from the Department of Revenue, the Legislative Services Division and my staff for your information.

Attachments

DOR Tax Year Analysis (January 17, 2018)
Legal Memo from DOR (January 12, 2018)
Legislative Services Division Legal Memo (January 11, 2018)
OBPP Fiscal Year Analysis (January 17, 2018)
General Fund Balance Sheet reflecting Federal Impacts



Mike Kadas
Director

Montana Department of Revenue



Steve Bullock
Governor

Memorandum

To: Dan Villa, Budget Director

From: Mike Kadas, Director *MK*

Date: January 17, 2018

Subject: Federal Tax Reform (HR 1) Impacts to the State's Budget

Following a thorough and deliberate legal review the department has concluded that there is a reasonable basis for determining that Qualifying Business Income (QBI) as defined in HR 1 is not an eligible deduction within Montana's personal income tax system. The department's estimate of tax year impacts of HR 1 is summarized in the table below.

Estimated Impacts of HR 1				
Program	In Millions			
	Tax Year 2018	Tax Year 2019	Tax Year 2020	Tax Year 2021
Individual Income Tax	5.3	8.3	8.1	8.1
Corporation Income Tax	(17.3)	(18.5)	(10.8)	(4.6)
Elimination of the ACA's Individual Mandate	0.0	(5.7)	(5.8)	(6.0)
Net State General Fund Impact	(12.0)	(15.9)	(8.5)	(2.5)

*Based on TY2018 payments

The legal analysis, which is attached, does raise concerns that the synthesis of HR 1 and Montana statutes is subject to competing legal theories. One of those theories could reduce general fund revenues by as much as an additional \$33 million per year. A similar analysis prepared by Jaret Coles of the Montana Legislative Services for Senate Majority Leader Fred Thomas (also attached) comes to a similar conclusion in Section 3.A. Mr. Coles has also concluded that reasonable grounds exist for a court to conclude that the 199A (or QBI) deduction is not available as a Montana itemized deduction.

Finally, the department would like to note that one other major impact of HR 1 on Montana revenues is the adoption of 100% expensing for capital investments in the corporate income tax. This new standard replaces what is known as "Accelerated Depreciation" or 50% expensing followed by a depreciation schedule. Montana is in the minority of

seventeen states that have not decoupled from this portion of the Internal Revenue Code. Thirty states have decoupled and use some standard depreciation schedule for expensing capital investments. The question is not applicable for four states as they do not have a tax to which bonus depreciation is relevant. Decoupling from this clause of HR 1 would eliminate the negative impacts of HR 1 on Montana's personal and corporate income tax structure.



Montana Department of Revenue



Mike Kadas
Director

Steve Bullock
Governor

MEMORANDUM OF LEGAL ADVICE

TO: Mike Kadas, Director
FROM: Dan Whyte, Chief Legal Counsel
DATE: January 12, 2018
SUBJECT: H.R. 1 2017 Part II, § 11011- Pass-Through Deduction

QUESTIONS PRESENTED

How does the newly created IRC § 199A impact Montana income tax law?

BRIEF ANSWER

Montana law, specifically §§ 15-30-2131 and 15-30-2132, MCA, gives Montana taxpayers the choice between itemizing deductions, including the items referred to in § 161 of the Internal Revenue Code (IRC), or taking the standard deduction against their Montana income tax.

H.R. 1 creates a new deduction in Part VI, Subchapter B, Chapter 1 of Title 26 of the IRC. The new deduction, codified in Part VI at IRC § 199A, is equal to 20% of "qualified business income" (QBI) a taxpayer receives. Inclusion of IRC § 199A in Part VI permits QBI as an item of deduction under IRC § 161.

Upon an initial reading, it appeared HR 1 would allow taxpayers who itemize their Montana deductions to be able to claim this new "below the line" federal deduction for qualified pass-through income when computing their Montana income tax. However, taxpayers who elect to take the standard deduction in Montana would not be eligible to take the new deduction against their Montana income tax.

Congress' amendments to the federal tax code via H.R. 1 are substantial. The Department continues reviewing H.R. 1 and analyzing its full impact to Montana tax law. This process is fluid and the full impacts will not be known for many months. However, because some of the effects of H.R. 1 are immediate, this is an expedited analysis providing several potential interpretations for consideration as to the application of IRC § 199A to Montana returns. Ultimately, the culmination of the varying opinions as to whether the 20% QBI is allowed as a deduction on a Montana individual income tax return has created disagreement about the application of the new pass-through deduction. By

adopting IRC § 199A as a deduction, but purposefully excluding QBI from the definitions of federal adjusted gross income and itemized deductions in the IRC, it is clear that Congress' intent is to prevent the QBI deduction from being claimed at the state level. Taking Congress' intent into consideration, it may be that deductions for QBI in Montana should not be allowed.

Introduced as the Tax Cuts and Jobs Act in the United States House of Representatives, H.R. 1 became Public Law No. 115-97 (H.R. 1) on December 22, 2017. This new federal legislation makes significant changes to the Internal Revenue Code that affect Title 15 of the Montana Code Annotated. This memorandum only addresses the new deduction for individuals with QBI.

Part II, § 11011(a) of H.R. 1 adds IRC § 199A, creating a new federal deduction for individual taxpayers who have QBI. See H.R. 1, 115th Cong. § 11011 (Dec. 22, 2017), at 10. The provisions of this new deduction apply to partnerships, LLCs, S Corps, and sole proprietors, with some specific exceptions. H.R. 1 amends several key sections of the IRC to make the QBI deduction available for taxpayers who take the standard deduction as well as those who itemize deductions against their federal income taxes. *Id.*, at 17.

The new § 199A is available as a deduction against federal income taxes for taxpayers who take the standard deduction as a result of Section 11011(b)(2). *Id.* That section of H.R. 1 amends IRC § 63(b) to permit non-itemizing taxpayers to take the standard deduction as well as the amounts permitted by the new IRC § 199A. *Id.*

H.R. 1 also adds QBI to the list of allowed deductions under Part VI, Subchapter B, Chapter 1 of the IRC for taxpayers who itemize. *Id.*, § 11011(a), at 10. The new deduction is specifically not allowed in computing a taxpayer's federal adjusted gross income through an amendment to IRC § 62(a). This prevents IRC § 199A from being used to reduce a taxpayer's federal adjusted gross income, meaning it cannot be taken as an "above the line" deduction. See § 11011(b), at 17.

ANALYSIS

The Department has conducted an initial review of the plain language of the application of § 199 to Montana deductions allowed. The § 11011 changes to the IRC have substantial impacts on the Montana income tax law structure. Section 15-30-2110, MCA, includes the definition of adjusted gross income (AGI) in Montana. Montana AGI is generally defined as a taxpayer's "federal adjusted gross income as defined in section 62 of the Internal Revenue Code," with specific Montana additions (§ 15-30-2110(1)(a)-(g), MCA) and deductions (§ 15-30-2110(2), MCA). § 15-30-2110, MCA. As described above, because IRC § 199A is specifically excluded as an above the line deduction under the amendment to IRC § 62, a taxpayer who claims the standard deduction under § 15-30-2132, MCA, when calculating state income tax has no mechanism by which QBI could be deducted from his or her Montana income taxes. See § 11011(b), at 17. This means that Montana taxpayers who take the standard deduction will not be entitled to claim the IRC § 199A deduction for QBI against their Montana income tax liability.

There is, however, a distinction between taxpayers who claim the Montana standard deduction as set forth in § 15-30-2132, MCA, and taxpayers who itemize their deductions as permitted by § 15-30-2131, MCA. Deductions allowed in Montana for computing net income includes “the items referred to in sections 161 . . . subject to . . .” certain nondeductible exceptions which do not apply to the new IRC § 199A. § 15-30-2131(1)(a), MCA. IRC § 161 permits “. . . the items specified in . . .” Part VI, Subchapter B, Chapter 1 of the IRC to be used as a deduction. 26 U.S.C. § 161. Part VI is where H.R. 1 enacts new section IRC § 199A. See H.R. 1, § 11011(b), at 17.

As the items referenced at IRC § 161 are specifically included as a part of the permitted deductions which can be claimed against a Montana taxpayer’s net income, it appears at first blush that this new IRC § 199A may be an item of deduction available to offset QBI to itemized individual income tax returns in Montana.

The Department has received a number of inquiries about the specific application of the amendment to IRC § 63(d) to the above analysis. The amendment to IRC § 63(d) added the following language at (3):

(d) For purposes of this subtitle, the term “itemized deductions” means the deductions allowable under this chapter other than . . . (3) the deduction provided in section 199A.

See H.R. 1, 115th Cong., § 11011, at 17. At the federal level, the result is clear: the deduction provided in IRC § 199A is available to individuals who itemize deductions at the federal level while simultaneously not included in the definition of the term “itemized deduction” for purposes of Chapter 1 of Subtitle A. *Id.* This is an example of language in H.R. 1 that demonstrates Congress’ intent to limit the § 199A deduction to the federal income taxes.

However, this amendment to IRC § 63(d) may not have the intended effect on Montana’s tax code. Other states have specifically adopted IRC § 63 to define state itemized deductions. See, e.g., Idaho Code § 63-3022(j)(2) (“there shall be allowed as a deduction . . . [i]temized deductions as defined in section 63 of the [IRC] . . .”); N.M. Stat. Ann. § 7-2-2(N)(2) (“‘net income’ means . . . base income adjusted to exclude . . . an amount equal to the itemized deductions defined in Section 63 of the [IRC].” (emphasis added)). It appears that a taxpayer in one of those states may not deduct QBI as an itemized deduction against their state income tax because new IRC § 199A is specifically excluded from the definition of “itemized deductions” as a result of the amendments to IRC § 63(d).

Montana, however, is not so clear. Montana does not conform to the federal definitions of itemized deductions and standard deductions. See §§ 15-30-2131 and § 15-30-2132. Moreover, unlike other states, Montana itemized deductions are not calculated with regard to the federal definition of “itemized deductions” at IRC § 63(d). Montana’s itemized deductions are listed in § 15-30-2131, MCA. The statute provides the starting place for calculating itemized deductions for Montana income tax purposes. As described

therein, the allowed deductions in computing net income are, among other things, “the items referred to in [IRC] § 161” subject to specifically articulated exceptions. § 15-30-2131(1)(a), MCA. Turning then to IRC § 161, that section of federal law permits “. . . the items specified in . . .” Part VI, Subchapter B, Chapter 1 of the IRC. As described previously, new § 199A is included in Part VI, Subchapter B, Chapter 1 of the IRC.

Although IRC § 63(d) was amended to exclude new IRC § 199A from the definition of “itemized deductions” at the federal level, Montana law may permit the deduction of QBI for taxpayers who itemize deductions against Montana income. If the intent of Congress is not taken into account, this is a likely conclusion that the courts may make.

There are other interpretations of the impacts of H.R. 1 as applied to Montana law that should be considered here. As previously indicated it does appear that the United States Congress did not intend for the IRC § 199A QBI deduction to apply against state income taxes. These other interpretations are consistent in that they conform to the apparent intent of Congress to not include QBI as a state deduction for Montana taxpayers who itemize deductions.

One interpretation of Montana law involves a specific review of IRC §§ 62 and 161. Federal adjusted gross income (FAGI) is defined at IRC § 62. Within the amendments provided by H.R. 1, the QBI deduction is specifically excluded from FAGI thereby it is excluded as a deduction against Montana income tax purposes as well. It follows that IRC § 161 can be read to incorporate IRC § 63. Montana law provides that Montana taxpayers may claim either the standard deduction, as specified at § 15-30-2132, MCA, or the deductions specified at § 15-31-2131, MCA. Under § 15-30-2131, MCA, there are allowed as deductions the items referred to in IRC § 161. As IRC § 161 provides: “In computing taxable income under section 63, there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).” This interpretation concludes that IRC § 63 cannot be excluded from Montana’s reference to IRC § 161 at § 15-30-2131 as that would be contrary to the language of that IRC § 161. Put another way, because § 161 incorporates by reference IRC § 63, including the federal definition of “itemized deductions” at IRC § 63(d), it is thereby adopted in Montana.

Another interpretation of the new IRC § 199A revolves around the “Other Definitions” that exist at IRC § 199A(e)(1). In relevant part, § 199A(e) provides: “Other definitions. For purposes of this section . . . (1) Taxable income shall be computed without regard to the deduction allowable under this section.” This interpretation has been presented as a potential means of separating IRC § 199A from the deductions allowable as itemized deductions in Montana, because it requires the deduction to be disregarded for purposes of determining “taxable income.”

Another interpretation involves the actual function of the QBI provision. The QBI provision is termed as a deduction because it comes out of FAGI. In essence, it takes the form of an exemption. There is a subtle difference between a business deduction, which is usually based on an expenditure, and an exemption, which is a non-taxable fraction of

net income not related to an expense (such as interest on a Roth IRA or a municipal bond). A deduction must be ordinary and necessary, while an exemption is self-referential and acts more like a credit. Because IRC § 199A meets these exemption characteristics, it may be treated as an exemption, thereby avoiding any potential conflict with § 15-30-2131, MCA, as a deduction.

Finally, another interpretation makes it clear that Montana frequently aligns its tax laws with those passed by Congress in the Internal Revenue Code and recognizes this as codified in § 15-30-2620(2), MCA:

Department rules — conformance with Internal Revenue Code. (1) The department may adopt rules and may require facts and information to be reported as it considers necessary to enforce the provisions of this chapter.

(2) If a term is not defined in this chapter, the term has the same meaning as it does when used in a comparable context in the Internal Revenue Code.

There are circumstances in Title 15 of the MCA when Montana has adopted IRC provisions. For instance, Montana has adopted IRC §§ 67 and 68 by incorporating the two percent floor on miscellaneous itemized deductions and the overall limitation on itemized deductions for state income tax purposes, though the Montana Code Annotated does not refer to those code sections explicitly. IRC §§ 67 and 68 both refer to “itemized deductions,” and Montana relies on the federal term “itemized deductions” under § 68 despite not specifically adopting the term in the Montana Code Annotated. By applying § 15-30-2620(2), MCA, and recognizing Montana’s history of relying on the federal definition, it can be concluded that Montana has adopted the federal definition of “itemized deductions” through its incorporation of the applicable sections into Montana’s state income tax scheme. See, also, 2017 Montana Individual Income Tax Return, Form 2. Under this application, the Department can conclude that the history of the adoption of the federal definition for “itemized deductions” in § 63(d), as applied to Montana, would disallow IRC § 199A deductions for state tax purposes.

CONCLUSION

Individual income tax filers in Montana may be treated differently for purposes of the newly enacted IRC § 199A depending on the application of H.R. 1 to Montana tax law. While Montana has codified portions of the Internal Revenue Code without wholesale adoption, Montana has also relied on federal definitions by incorporation that raise an ambiguity as to the application of IRC § 199A to Montana state tax returns.



Montana Legislative Services Division
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January 11, 2018

Senator Fred Thomas
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Dear Majority Leader Thomas:

This memorandum is in response to your request for a legal opinion regarding whether newly enacted Internal Revenue Code section 199A can be claimed as a state itemized deduction under section [15-30-2131](#), MCA. As part of your question, you specifically asked me to analyze a Department of Revenue ("Department") internal¹ memorandum of legal advice dated December 28, 2017, and supplemented January 4, 2018, regarding this subject.

Before I provide you with my opinion and analysis, a caveat is necessary. Due to the constitutional constraints inherent in the separate powers of each branch of state government, a legal opinion provided to you by a Legislative Branch attorney is obviously not binding on the Department as an Executive Branch agency.

Parts 1 and 2 of the legal analysis for this memorandum provide a general overview of the Montana individual income tax system as a matter of background. If you do not desire to read the background material, you can find the legal analysis for your question in part 3 of the legal analysis.

QUESTION PRESENTED

Do reasonable grounds exist for a court to conclude that the newly enacted section 199A deduction is not available as a Montana itemized deduction?

SHORT ANSWER

Yes. The federal government's recent enactment of the Tax Cuts and Jobs Act changes the landscape of the federal income tax. Since most states adopt provisions of the Internal Revenue Code, there will also be changes to the tax laws of several states. Montana is not unique in this regard. However, Montana is somewhat unique in the way it determines what specific federal itemized deductions are available as state itemized deductions. This is relevant, as Congress recently enacted a new section 199A deduction that allows certain taxpayers with pass-through income to claim a deduction on a federal return for certain qualified business income. In adopting the new deduction, Congress expressly declared that it is not used in determining federal adjusted

¹The memorandum is addressed to the Director of the Department of Revenue from Tax Counsel. Internal memorandums lack the force of law granted to administrative rules. See section [2-4-102\(14\)](#), MCA.

gross income, federal itemized deductions, or the federal standard deduction. Nevertheless, the Department's internal memorandum concludes that the new section 199A deduction can be claimed as a state itemized deduction. This conclusion is based on the manner in which Montana adopted certain federal itemized deductions decades ago, without adopting the federal definition for "itemized deductions" in section 63 of the Internal Revenue Code. Had Montana adopted the definition in section 63, then the potential issue would not exist. This memorandum challenges the conclusion that a section 199A deduction is available in Montana.

First, from a historical standpoint Montana has utilized the federal definition for "itemized deductions" in section 63 of the Internal Revenue Code by restricting the deductibility of state itemized deductions. This approach is defensible, as state statute permits the utilization of Internal Revenue Code definitions when a term is not defined in the Montana Code Annotated. Given that Montana has already utilized the federal definition for "itemized deductions" it could likewise follow the same line of reasoning to deny the section 199A deduction. (*See* Subpart 3.B)

Second, the statute in which Montana adopts certain federal itemized deductions could be interpreted in a manner in which federal deductibility is a prerequisite to state deductibility. To find otherwise would mean that the state would be required to allow deductions that are not allowable at the federal level. Such an interpretation does not fit the purpose of adopting a federal code. (*See* Subpart 3.C)

Finally, deductions are a matter of legislative grace. Pursuant to state statute, all income is taxable unless expressly provided. A reasonable argument can be asserted that the section 199A deduction is not expressly provided. Moreover, based on existing Montana Supreme Court precedent a court could declare that treating section 199A as an itemized deduction results in the statute is being applied in a manner that results in unlawful delegation of legislative authority. (*See* Subpart 3.D).

LEGAL ANALYSIS

1. ROLLING CONFORMITY AND THE NEWLY CREATED SECTION 199A QUALIFIED BUSINESS INCOME DEDUCTION

The structure of Montana's personal income tax is based on federal tax law. This structure is not uncommon. According to a recent report from the National Conference of State Legislatures, "[m]ost state tax codes conform to the federal tax code in terms of how they define income."² As such, whenever Congress adds another exclusion or deduction, the same feature can automatically appear (i.e., rolling conformity) in the Montana income tax without any action from the Legislature. There are 22 other states that use rolling conformity, while 17 states have

² National Conference of State Legislatures (NCSL), [Federal Tax Reform and the States](http://www.ncsl.org/research/fiscal-policy/federal-tax-reform-and-the-states.aspx), available at <http://www.ncsl.org/research/fiscal-policy/federal-tax-reform-and-the-states.aspx> (last visited Jan. 5, 2018).

static conformity, which means they must adopt federal changes that are desired.³

When a reference appears to a specific provision of the Internal Revenue Code it encompasses "those provisions as they may be otherwise labeled or further amended."⁴ Additionally, in the event a term is not defined in Montana law "the term has the same meaning as it does when used in a comparable context in the Internal Revenue Code".⁵

On December 22, 2017, the [Tax Cuts and Jobs Act](#)⁶ ("H.R. 1") was signed by the President and became law.⁷ The enacted version of the bill is 185 pages long and impacts the federal income tax system in a variety of ways. A large portion of the changes to the federal individual income tax code are temporary and expire at the end of 2025.⁸ Instead of analyzing all the federal changes, the focus of this memorandum is limited to an analysis of whether a new federal Internal Revenue Code provision titled Qualified Business Income ("QBI") and enacted in section 199A of the Internal Revenue Code is a Montana itemized deduction. If allowable, the new deduction could result in certain taxpayers claiming a deduction at the state level in an amount up to 20% of QBI received by a taxpayer from a pass-through entity starting in tax year 2018.

Department legal counsel reviewed the issue of whether the new section 199A deduction impacts the Montana income tax in an internal memorandum of legal advice to the Director of the Department dated December 28, 2017, and supplemented January 4, 2018. The internal memorandum concludes that taxpayers who itemize their Montana deductions will be able to claim the section 199A deduction for QBI when computing their Montana income tax.

2. OVERVIEW OF THE MONTANA INDIVIDUAL INCOME TAX

A. Gross Income Calculation

The Montana income tax starts by adopting the federal concept of gross income. Pursuant to section [15-30-2101](#), MCA, gross income "means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code (26 U.S.C. 61) or as that section may be labeled or amended", excluding certain unemployment compensation. Section

³ *Id.*

⁴ Section [15-30-2101](#), MCA.

⁵ Section [15-30-2620](#)(2), MCA.

⁶ [Public Law No. 115-97](#), available at <https://www.congress.gov/115/bills/hr1/BILLS-115hr1enr.pdf> (last visited Jan. 9, 2018).

⁷ See [H.R. 1's Bill History](#), available at <https://www.congress.gov/bill/115th-congress/house-bill/1>

⁸ NCSL, *supra* note 2.

61(a) of the Internal Revenue Code, in turn, provides that unless provided otherwise gross income "means all income from whatever source derived". The United States Supreme Court, in *Commissioner v. Glenshaw Glass Co.*⁹, determined that the definition of gross income is broad and that Congress intended to exert "the full measure of its taxing power". Likewise, the Montana definition of gross income is comprehensive.

- *Federal Legislation Impact:* H.R. 1 amended section 61(a) of the Internal Revenue Code regarding a reference to a repealed deduction for alimony payments.¹⁰ This amendment does not directly impact the calculation of the new section 199A deduction.¹¹

B. Adjusted Gross Income Calculation

After determining gross income, the next step in calculating Montana income tax is to calculate Montana adjusted gross income. Pursuant to section [15-30-2110](#), MCA, except as otherwise provided "adjusted gross income is the taxpayer's federal adjusted gross income as defined in section 62 of the Internal Revenue Code, 26 U.S.C. 62". Section 62(a) of the Internal Revenue Code, in turn, defines adjusted gross income (AGI) as gross income minus certain specific deductions, most of which contain restrictions that are detailed in other code sections. The deductions listed in section 62 of the Internal Revenue Code are often referred to as "above the line" deductions. Individual taxpayers are allowed to deduct above the line deductions, regardless of whether they itemize or claim the standard deduction. Consequently, decisions of Congress can have a direct impact on Montana AGI. However, there are multiple items that are specifically included and excluded (*i.e.*, additions and subtractions) in Montana AGI regardless of what Congress does. The Legislature frequently amends section [15-30-2110](#), MCA, to deviate from and supplement the federal definition of AGI.

- *Federal Legislation Impact:* H.R. 1 amended section 62 of the Internal Revenue Code in multiple places. One of the impacts of the amendments to this code section is to ensure that a taxpayer claims the new section 199A deduction as an independent deduction that is not associated with the calculation of federal AGI. Given that federal AGI is not impacted by the deduction, Montana AGI is not impacted. The Department's internal memorandum similarly concludes that the new section 199A deduction cannot be used as

⁹ *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 429 (1955).

¹⁰ Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11051, p. 36 ("Subsection (a) of section 61 is amended by striking paragraph (8) and by redesignating paragraphs (9) through (15) as paragraphs (8) through (14), respectively.")

¹¹ Section 199A contains limits that are tied to taxable income. Given that H.R. 1 eliminates the alimony deduction for certain spouses that pay alimony, there is an indirect impact from this amendment at the federal level.

an above the line deduction.¹²

C. Itemized vs. Standard Deduction

Similar to the federal income tax, Montana allows taxpayers to choose between itemized deductions or a standard deduction. Generally Montana income tax will be less if a taxpayer takes the larger of the itemized deductions or the standard deduction.

The determination of what is allowed for purposes of claiming itemized deductions starts out with a reference to the federal tax code. Pursuant to section [15-30-2131](#), MCA, the items referred to in sections 161 and 211 of the Internal Revenue Code are deductible, with some exceptions. Additionally, similar to the calculation of Montana AGI, taxpayers are prohibited from taking certain deductions and allowed to take others regardless of what Congress does. The Legislature has not amended section [15-30-2131](#), MCA, since 2005.

A taxpayer who does not itemize is allowed to claim a Montana standard deduction. Unlike the Montana itemized deduction, the standard deduction is not tied to federal law and congressional changes do not impact it. Pursuant to section [15-30-2132](#), MCA, the minimum standard deduction is the greater of \$1,980 (plus a statutory adjustment for inflation) or 20% of Montana AGI and the maximum standard deduction is \$4,460 (plus a statutory adjustment for inflation). Taking the inflation factor¹³ into account, the maximum standard deduction was \$4,370, \$4,460 and \$4,510 for tax years [2015](#), [2016](#), [2017](#), respectively.

- *Federal Legislation Impact:* H.R. 1 amended sections 62 and 63 of the Internal Revenue Code in multiple places to ensure that the new section 199A deduction is an independent deduction on a federal income tax return that is not associated with the calculation of federal AGI, federal itemized deductions, or the federal standard deduction. In other words, a taxpayer can elect to claim federal itemized deductions or the federal standard deduction. Presumably one of the policy decisions of allowing taxpayers to claim the section 199A deduction as a stand alone federal deduction is to encourage more taxpayers to claim the higher federal standard deduction, which in turn would lower the amount of taxpayers that would claim federal itemized deductions.
- The Department's internal memorandum concludes that the new section 199A deduction can be claimed as an itemized deduction on a Montana income tax return, even though it

¹² Department of Revenue Internal Memorandum, p. 2 (reasoning that "IRC § 199A is specifically excluded as an above the line deduction" for state tax purposes).

¹³ Pursuant to section [15-30-2101](#), MCA, inflation factor "means a number determined for each tax year by dividing the consumer price index for June of the previous tax year by the consumer price index for June 2015."

cannot be claimed as an itemized deduction on a federal return.¹⁴ Given the complexity of this issue, part 3 of the analysis addresses this interpretation. Ultimately, I would not recommend that a taxpayer claim a section 199A deduction on a Montana return as an itemized deduction unless the Department formally adopts this approach.

D. Montana Personal Exemptions

Similar to the federal income tax (prior to H.R. 1), Montana allows taxpayers to claim personal exemptions.¹⁵ The Montana personal exemption is not tied to federal law and it exists irrespective of what Congress does. Pursuant to section [15-30-2114](#), MCA, the personal exemption is adjusted for inflation and is calculated by multiplying the dollar amount of the exemption by the number of exemptions (*i.e.*, taxpayer, spouse, children, dependents, additional exemption for age 65 and above, additional exemption for blind). Taking the inflation factor into account, each personal exemption was \$2,330, \$2,380, and \$2,400 for tax years [2015](#), [2016](#), [2017](#), respectively.

- *Federal Legislation Impact:* H.R. 1 amended the federal statute regarding personal exemptions by an amendment that states "The term 'exemption amount' means zero" for tax years 2018 through 2025.¹⁶ The Montana Code Annotated does not adopt the federal personal exemption statute, so a personal exemption is still available on a Montana return.

E. Calculate Montana Taxable Income

Pursuant to section [15-30-2101](#), MCA, Montana taxable income "means the adjusted gross income of a taxpayer less the deductions and exemptions provided for" under the Montana tax code. As such, taxable income is calculated using Montana AGI, the higher of itemized deductions or the standard deduction (assuming a taxpayer elects to use the higher of the two), and allowable personal exemptions.

F. The Last Step -- Montana Tax Calculation.

Montana uses a single rate structure for all taxpayers, regardless of filing status.¹⁷ The rate structure is modified by the Department on a yearly basis by the inflation factor for the tax year,

¹⁴ Department of Revenue Internal Memorandum, p. 3 (reasoning "new IRC § 199A is an item of deduction available to offset QBI from pass-through entities to itemized individual income tax returns in Montana").

¹⁵ Section 151 of the Internal Revenue Code; Section [15-30-2114](#), MCA.

¹⁶ Section 151 of the Internal Revenue Code, as amended by the Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11041, p. 29.

¹⁷ See section [15-30-2103](#), MCA.

as rounded to the nearest \$100.¹⁸ Montana's rate structure is progressive, since taxpayers with higher incomes pay a higher percentage of their income in tax. However, unlike the federal brackets Montana's rates max out at a fairly low level of taxable income. The easiest way to calculate total Montana tax is to use the rate tables published by the Department. These tables have already taken into account the progressive rates of tax and the inflation factor.

3. THERE ARE REASONABLE GROUNDS FOR A COURT TO CONCLUDE THAT THE NEWLY CREATED SECTION 199A DEDUCTION IS NOT AVAILABLE AS A MONTANA ITEMIZED DEDUCTION

H.R. 1 amended sections 62 and 63 of the Internal Revenue Code in multiple places.¹⁹ The overall impact of the amendments to these code sections ensure that a taxpayer filing a federal return may claim the new section 199A deduction as an independent deduction that is not associated with the calculation of federal AGI, federal itemized deductions, or the federal standard deduction. In other words, federal AGI is not impacted by the deduction and a taxpayer can elect to claim federal itemized deductions or the federal standard deduction. Presumably one of the policy decisions to allow taxpayers to claim the section 199A deduction as a stand-alone deduction is to encourage more taxpayers to claim the higher federal standard deduction, which in turn would lower the amount of taxpayers that would claim federal itemized deductions. Consequently, treating the section 199A deduction as a Montana itemized deduction is a major deviation from the federal system.

Subpart 3.A. starts with an overview of the legal standard that the Department must satisfy when analyzing a Montana income tax statute. Subpart 3.B. reviews past practices in state taxation and the administration of itemized deductions to conclude that reasonable arguments can be made for Montana to follow the federal definition of "itemized deductions" for the purpose of determining that the new section 199A deduction is not a Montana itemized deduction. Subpart 3.C. reviews additional statutory language in the Montana itemized deduction code section to formulate an argument that Montana should not allow state itemized deductions when itemized deductions are not allowed on a federal return. And finally, subpart 3.D concludes that treating section 199A as an itemized deduction could result in the statute being applied in a manner that results in unlawful delegation of legislative authority.

A. Department's Internal Memorandum and Overview of Standard.

The purpose of this memorandum is not to disagree with the logic of the Department's internal memo, which represents the types of arguments that the Department could expect in the event the section 199A deduction is formally disallowed by the Department. Instead of disagreeing with

¹⁸ *Id.* Montana's initial inflation factor was enacted by initiative in 1980. Sec. 2, I.M. No. 86, approved Nov. 4, 1980.

¹⁹ Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11011, p. 17.

the internal memo, this memorandum applies the legal standard that a court would apply to conclude that there are other reasonable interpretations. The Montana Supreme Court provided that the standard is as follows:

"When the Department has only the language of the Montana revenue code on which to base its interpretation of a specific code section, we will not disagree with the Department's interpretation if that interpretation is reasonable."²⁰

In other words, the focus of this part is to provide other arguments that could be asserted in defending the position that the state of Montana did not adopt the new section 199A deduction through the statutory language of section [15-30-2131](#), MCA. Ultimately, the fact that multiple arguments can be made for and against treating the newly enacted section 199A deduction as a state itemized deduction shows that the Legislature may desire to clarify at some point in the future whether this exemption is available.

B. Past Practice Shows that the Department Already Relies on the Federal Definition for Itemized Deductions

This subpart reviews the position in the Department's internal memorandum and does not restate all the issues in that memo. As such, it is helpful to read the Department's internal memo prior to reading this subpart.

The determination of what is allowed for purposes of claiming state itemized deductions starts out with a reference to the federal tax code. Section [15-30-2131](#), MCA, provides:

15-30-2131. Deductions allowed in computing net income. (1) In computing net income, *there are allowed as deductions:*

(a) *the items referred to in sections 161, including the contributions referred to in 33-15-201(5)(b), and 211 of the Internal Revenue Code, 26 U.S.C. 161 and 211, subject to the following exceptions, which are not deductible: . . . (emphasis added)*

Section 161 of the Internal Revenue Code, in turn, provides:

Allowance of deductions. In computing taxable income under section 63, *there shall be allowed as deductions the items specified in this part [i.e., Part VI of Subchapter B, Chapter 1, Subtitle A], subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible). (emphasis added)*

²⁰ *Baitis v. Dep't of Revenue*, 2004 MT 17, ¶ 24, 319 Mont. 292, 83 P.3d 1278.

The Department's internal memorandum relies on the interplay of section [15-30-2131](#), MCA, and section 161 of the Internal Revenue Code in determining that the "plain language of Montana law permits the deduction of QBI [*i.e.*, section 199A] for taxpayers who itemize deductions against Montana income."²¹ As I understand the memo, the reasoning is based on a portion of the above italicized language of section 161 of the Internal Revenue Code, which allows deductions to the items specified in Part VI of Subchapter B, Chapter 1, Subtitle A of the Internal Revenue Code. In other words, the position is that section 199A is a deduction in calculating Montana net income based on the fact that it is codified in the same part of the Internal Revenue Code that is adopted in the Montana Code Annotated. The fact that the Internal Revenue Code also prohibits a federal taxpayer from claiming the section 199A deduction as an itemized deduction is not a determining factor in the memorandum, as Congress did not codify the prohibition in the part that is adopted by reference (*i.e.*, part VI).²² The conclusion in the memo is driven by the fact that other states take a different approach than Montana by adopting the federal definition of "itemized deductions" in section 63 of the Internal Revenue Code, which provides for all allowable deductions, except for the deductions allowable in arriving at adjusted gross income, personal exemptions, and now the newly enacted section 199A deduction.

As a matter of background, the Internal Revenue Code is organized by Subtitle, Chapter, Subchapter, and Part. When language from the Internal Revenue Code cites to "this part", the reference is to the same Subtitle, Chapter, and Subchapter where the reference to "this part" appears. As applied here, the part that is incorporated by reference in section [15-30-2131](#), MCA, is labeled "[Itemized Deductions for Individuals and Corporations](#)", which encompasses sections 161 through newly enacted 199A of the Internal Revenue Code. As such, a variety of federal itemized deductions are codified in this part. The subchapter where this part located is labeled "[Computation of Taxable Income](#)", which encompasses sections 61 through 291 of the Internal Revenue Code.

[Sections 61 through 68 of the Internal Revenue Code](#) set out important foundational concepts for the federal income tax. As discussed earlier in this memo, Montana relies on the federal definition of gross income²³ and adjusted gross income²⁴ to set the foundation. Montana did not adopt the comprehensive federal definition of "itemized deductions" in section 63 of the Internal Revenue Code, which before H.R. 1 provide for all allowable deductions²⁵, except for the

²¹ Department of Revenue Internal Memorandum, p. 3 (last paragraph).

²² Department of Revenue Internal Memorandum, p. 3.

²³ Section 61 of the Internal Revenue Code; section [15-30-2101](#), MCA.

²⁴ Section 62 of the Internal Revenue Code; section [15-30-2110](#), MCA.

²⁵ Section 63 of the Internal Revenue Code permits a federal taxpayer to pick between the standard deduction or itemized deductions, but does not allow a taxpayer to claim both.

deductions allowable in arriving at adjusted gross income and personal exemptions. Instead, Montana limited the federal definition of itemized deductions by requiring the state itemized deductions to be in specific parts of the Internal Revenue Code. At the time of enactment, this approach was more restrictive than citing to the broader term in section 63 of the Internal Revenue Code.

As applied here, the fact that Montana itemized deductions are provided for in a section outside of the foundational sections 61 through 68 does not necessarily mean these code sections do not have a bearing on Montana itemized deductions. As one prime example, section 68 of the Internal Revenue Code limits the amount of allowable federal "itemized deductions" that a taxpayer can take for certain higher income taxpayers.²⁶ In order to limit the deduction, section 68 relies on the federal term "itemized deductions"²⁷, which again, is not directly adopted in the Montana Code Annotated. Nonetheless, Montana applies an income-based limit at the state level by lowering the amount of state itemized deduction a taxpayer may claim for certain higher income taxpayers.²⁸ This calculation can be found on the [2017 Schedule III](#) – Montana Itemized Deductions (line 30), on the [2017 Worksheet VI-IDL](#) – Itemized Deduction Limitation, and is further defined in Montana Administrative Rule [42.15.425](#) (reasoning that "when the deductions allowed under [15-30-2131](#), MCA, are limited to a percent of adjusted gross income by reference to the IRC, Montana adjusted gross income must be used when calculating the deductions limitation for the Montana return").

As another example, [section 67](#) of the Internal Revenue Code limits the amount of allowable federal "miscellaneous itemized deductions" that a taxpayer can take "to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income."²⁹ In order to limit the deduction, section 67 modifies the federal term "itemized deductions"³⁰, which, again, is not

²⁶ Section 68 of the Internal Revenue Code was amended by H.R. 1 by suspending the overall limitation on itemized deductions for tax years 2018 through 2025. Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11046, p. 35.

²⁷ Section 68(c) of the Internal Revenue Code relies on the term "itemized deductions" from section 63(d) of the Internal Revenue Code, but it modifies it further by stating that for the purpose of the reduction statute, the term does not include: "(1) the deduction under section 213 (relating to medical, etc. expenses), (2) any deduction for investment interest (as defined in section 163(d)), and (3) the deduction under section 165(a) for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d)."

²⁸ This reduction occurs, despite the fact that section 68 of the Internal Revenue Code is not incorporated in the Montana Code Annotated, and despite the fact that some of the items that are reduced are incorporated through section [15-30-2131](#), MCA.

²⁹ Section 67 of the Internal Revenue Code was amended by H.R. 1 by suspending the ability of a taxpayer to claim miscellaneous itemized deductions for tax years 2018 through 2025. Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11045, p. 35.

³⁰ Section 67(b) of the Internal Revenue Code relies on the term "itemized deductions" from section 63(d) of the Internal Revenue Code by defining miscellaneous itemized deductions as all "itemized deductions" other than the following:

directly adopted in the Montana Code Annotated. Nonetheless, Montana applies the 2 percent calculation at the state level by lowering the amount of state "miscellaneous itemized deductions" a taxpayer may claim.³¹ This calculation can be found on the [2017 Schedule III – Montana Itemized Deductions](#) (line 25).

In short, Montana appears to have a history of relying on the federal definition for "itemized deductions" when applying limitations to Montana itemized deductions, despite the reasoning in the internal memorandum that Montana should not rely on this federal definition. This historic approach is defensible, as section [15-30-2620\(2\)](#), MCA, provides that if a term is not defined in the Montana individual income tax code, "the term has the same meaning as it does when used in a comparable context in the Internal Revenue Code".

Similar to past practice, there appears to be reasonable grounds to deny a section 199A deduction on a Montana return. This is the case, as section 63(d) of the Internal Revenue Code as amended by H.R.1 specifically states that for the purposes of [subtitle A](#) (*i.e.*, the federal income tax) "the term 'itemized deductions' means the deductions allowable under this chapter³² *other than—*

- (1) the deductions allowable in arriving at adjusted gross income,

-
- (1) the deduction under section 163 (relating to interest),
 - (2) the deduction under section 164 (relating to taxes),
 - (3) the deduction under section 165(a) for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d),
 - (4) the deductions under section 170 (relating to charitable, etc., contributions and gifts) and section 642(c) (relating to deduction for amounts paid or permanently set aside for a charitable purpose),
 - (5) the deduction under section 213 (relating to medical, dental, etc., expenses),
 - (6) any deduction allowable for impairment-related work expenses,
 - (7) the deduction under section 691(c) (relating to deduction for estate tax in case of income in respect of the decedent),
 - (8) any deduction allowable in connection with personal property used in a short sale,
 - (9) the deduction under section 1341 (relating to computation of tax where taxpayer restores substantial amount held under claim of right),
 - (10) the deduction under section 72(b)(3) (relating to deduction where annuity payments cease before investment recovered),
 - (11) the deduction under section 171 (relating to deduction for amortizable bond premium), and
 - (12) the deduction under section 216 (relating to deductions in connection with cooperative housing corporations)."

³¹ This reduction to a deduction occurs, despite the fact that section 67 of the Internal Revenue Code is not incorporated in the Montana Code Annotated, and despite the fact that items that are reduced are incorporated through section [15-30-2131](#), MCA. See also [2016 Montana Form 2 with MCA and ARM Citations](#), Schedule III – Montana Itemized Deductions (line 25) (citing [ARM 42.15.525](#) as the source for the 2 percent calculation).

³² [Chapter 1 of subtitle A](#) is entitled "normal taxes and surtaxes", which includes the federal individual income tax.

(2) the deduction for personal exemptions provided by section 151, and,

(3) *the deduction provided in section 199A.*³³

As discussed in the Department's internal memorandum and a good portion of this memo, Montana does not expressly adopt section 63(d) of the Internal Revenue Code. Montana's approach is to adopt specific parts of the Internal Revenue Code that contain the bulk of federal itemized deductions, which happen to include the new section 199A deduction. This leads to the conclusion in the Department's internal memorandum that new section 199A is a Montana itemized deduction, which effectively ends the analysis. Yet, the amendment to section 63(d) applies to the entire federal income tax code, including the parts of the federal income tax code adopted by Montana law. By applying section [15-30-2620\(2\)](#), MCA, the Department could conclude that the federal definition for "itemized deductions" in section 63(d) of the Internal Revenue Code, which disallows the new section 199A deduction, can also be applied to deny it as a Montana itemized deduction. Indeed, a section 199A deduction will not appear as an itemized deduction on the 2018 federal income tax return.

C. Additional Statutory Language Supports a Reasonable Argument That the Legislature Did not Intend to Allow State Itemized Deductions When Itemized Deductions Are Not Allowed on a Federal Return.

A tie to the federal system lowers the Department's costs of administering the income tax while simultaneously lowering a taxpayers' costs of complying.³⁴ Allowing federal deductions to be claimed on a state return regardless of whether they are allowed on a federal return does not satisfy this goal.³⁵ In denying the section 199A deduction as a state itemized deduction, the Department could look at additional language in section 161 of the Internal Revenue Code. Section [15-30-2131](#), MCA, provides: "In computing net income, there are allowed as deductions . . . the items referred to in sections 161 . . . of the Internal Revenue Code"

Section 161 of the Internal Revenue Code, in turn, provides:

Allowance of deductions. *In computing taxable income under section 63, there shall be allowed as deductions the items specified in this part [i.e., Part VI of Subchapter B, Chapter 1, Subtitle A],*

³³ Section 63(d) of the Internal Revenue Code, as amended by the Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11011, p. 17 (emphasis added).

³⁴ Montana Department of Revenue, [Biennial Report: July 1, 2008 – June 30, 2010](#), p. 54 (2010).

³⁵ On occasion Montana adopts portions of the Internal Revenue Code that are not followed at the federal level. However, the manner in which the adoption occurs is express. For example, in section [15-30-2131\(1\)\(d\)](#), MCA, the Montana Legislature made a policy decision to allow political contributions that were allowable under a provision of the Internal Revenue Code that has since been repealed.

subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible). (emphasis added)

An important question is whether the above italicized language that references section 63 of the Internal Revenue Code is relevant. The Legislature clearly intended to allow deductions in part VI, but does this mean all deductions in this part are automatically Montana itemized deductions? If the federal government were to eliminate all the deductions to part VI through another part of the federal income tax code by stating that all the deductions in part VI do not exist, would Montana still be required to allow the deductions in part VI? Or does Montana also look to the other language in section 161, which would require the deduction to be utilized for the calculation of federal income tax before the item can be considered for Montana income tax purposes. There is a clear statutory link at the federal level between sections 63 and 161 of the Internal Revenue Code. If the italicized language is relevant to interpreting Montana's approach to calculating itemized deductions, then the H.R. 1 amendment to section 63(d) that prevents a section 199A deduction from being a federal itemized deduction is particularly relevant. Looking at this statutory structure, one reasonable argument is that the state does not adopt federal itemized deductions in parts VI and VII when they are not available at the federal level.³⁶ Consequently, a section 199A deduction would not be available as a state itemized deduction.

D. Deductions Are a Matter of Legislative Grace -- Delegation of Legislative Power

There is a fundamental question of whether the Legislature intended to allow taxpayers to claim a deduction that was impossible for the Legislature to contemplate. In general, tax deductions are a matter of legislative grace and a taxpayer must clearly demonstrate the right to a claimed deduction. *Robison v. Mont. Dep't of Revenue*, 2012 MT 145, ¶ 12, 365 Mont. 336, 340, 281 P.3d 218, 222; *Baitis v. Department of Revenue*, 2004 MT 17, ¶ 28, 319 Mont. 292, 83 P.3d 1278. In order to firm up this concept, the Legislature provided in section [15-30-2102](#), MCA, that "*all income except what has been expressly exempted under the provisions of this chapter [i.e., Montana Individual Income Tax] and income not permitted to be taxed under the constitution of this state or the constitution or laws of the United States shall be included and considered in determining the net income of taxpayers within the provision of this chapter.*" (emphasis added). The analysis of whether Montana expressly exempted the new section 199A deduction is complex, and a taxpayer that desires to claim such a deduction would need to clearly demonstrate that the statute allows it. Given the complexity involved and the arguments that can be put forward, I would not recommend that a taxpayer claim the deduction without an official adoption of the approach by the Department.

³⁶ This is particularly relevant, as H.R. 1 suspended the deductibility of federal miscellaneous deductions in section 67 of the Internal Revenue Code. See Tax Cuts and Jobs Act, [Public Law No. 115-97](#), § 11045, p. 35 (Section 67 was amended by adding: "Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026."). The suspended items cannot be deducted at the federal level and they do not reduce federal taxable income. However, the items that are suspended are some of the same items that are adopted by section [15-30-2131](#), MCA. Legislative staff is currently researching this potential issue.

Moreover, there is a critical questions as to whether a court would even need to analyze the statutory text in great detail. Instead of spending time circling around the Internal Revenue Code and the state tax code, a court could reason that treating section 199A as an itemized deduction results in the statute being applied in a manner that results unlawful delegation of legislative authority. As an example, *Lee v. State of Montana*³⁷, is a case in which a motorist challenged the 55 m.p.h. speed limit. To continue to receive federal highway funding, the Legislature provided that if Congress required a speed limit the Attorney General "shall" by proclamation adopt a speed limit and "shall" make further proclamations if federal law was changed. The Montana Supreme Court held that the proclamation powers were an unconstitutional delegation of legislative authority to the Attorney General. Because of the mandatory directions to the Attorney General, the Court said, "[a] more blatant handover of the sovereign power of this state to the federal jurisdiction is beyond our ken."³⁸ As applied here, the Court could likewise find that adopting a newly minted income tax deduction that has a large negative fiscal impact is an unconstitutional delegation of legislative authority. In fact, the adoption of a section 199A deduction is arguably more of a "handover" than the one in *Lee*, as the concept was just enacted by Congress and the Legislature did not have the opportunity to debate it, let alone enact it.³⁹

CONCLUSION

Ultimately there are a variety of reasonable arguments regarding why the section 199A deduction should not be treated as a state itemized deduction. As such, I would not recommend that a taxpayer claim the new section 199A deduction as a state itemized deduction without formal adoption of the concept by the Department through the administrative rulemaking process.

One way to clear up this matter would be through legislation that is drafted in a manner that is similar to how other states adopt the federal definition of "itemized deductions", or through a specific disallowance of the section 199A deduction in section 15-30-2131, MCA.

³⁷ *Lee v. State*, 195 Mont. 1, 635 P.2d 1282 (1981).

³⁸ *Id.* at 9.

³⁹ A few states have sidestepped the potential problem of unconstitutional delegation of legislative powers by determining that a state tax enacted by the legislature can use changing federal law for the computation of the amount payable to the state because the legislature determines whether the tax exists or will continue to exist and the tax is not established independent of the state's legislative action. See *In re Estate of West*, 226 Neb. 813, 415 N.W.2d 769 (1987). Similar arguments could be utilized to defend Montana's existing structure of taxation when federal changes pertain to computational matters, or perhaps even matters revolving around the timing of deductions to ensure that the federal return and Montana return are comparable. The section 199A deduction is much broader.

I hope that I adequately addressed your question. If you have any further questions, do not hesitate to contact me.

Sincerely,

Jaret R. Coles
Legislative Staff Attorney

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OFFICE OF THE GOVERNOR
BUDGET AND PROGRAM PLANNING
STATE OF MONTANA

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GOVERNOR



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To: Dan Villa, Budget Director
From: OBPP Revenue Team.
Ryan Evans, Asst. Budget Director; Ralph Franklin, Lead Revenue Analyst; Chris Watson, Sr. Revenue Analyst; Nancy Hall, Lead Budget Analyst; & Brian Hannan, Sr. Budget Analyst

Date: January 17, 2017

Based on the Department of Revenue (DOR) tax year liability estimates under recent federal tax legislation, and OBPP estimates for insurance premiums tax, the following table presents the impact of recent Federal legislation (H.R. 1) on state receipts by fiscal year.

Estimated Impact of Federal Tax Law Change on State Revenue by Fiscal Year (\$ Million)					
	FY 2018	FY 2019	FY 2020	FY 2021	2019 Biennium
Individual Income Tax	1.1	8.4	8.2	8.1	\$9.4
Corporate Income Tax	(8.7)	(17.9)	(14.7)	(7.7)	-\$26.6
Insurance Premium Tax	-	(2.8)	(5.7)	(5.9)	-\$2.8
Total	-\$7.6	-\$12.3	-\$12.2	-\$5.5	-\$19.9

Federal budget "PAYGO" rules are no longer assumed to sequester federal mineral royalty payments.

For most estimates, fiscal year revenue effects are assumed to be 50% of the prior tax year and 50% of the current tax year. However, for individual income tax, "safe-harbor" rules will affect estimated tax payments, and taxpayers are assumed to delay adjustments in state withholding. These lags are assumed to be trued-up with April 2019 tax filings for TY 2018. For this reason, the distribution of FY 2018 payments is assumed to be 20% of TY 2018 changes in liability. The other 80% of TY 2018 liability is assumed to be resolved in April 2019, during FY 2019, with final payments, refunds, and net estimated payments.

The corporation income tax (CIT) reductions are principally due to depreciation and expensing rule changes with the treatment of dividends only partially offsetting costs. DOR's December 19, 2017 updated CIT analysis incorporate new information on repatriated profits and territorial tax system changes from Joint Tax Committee (JTC) estimates of federal effects. When scaled to Montana these have *de minimis* positive effects on state tax collections.

FY 2017 and 2019 Biennium General Fund Status (Millions \$)			
Reflects November Special Session Actions			
Description	Actual	Enacted	
	FY 2017	FY 2018	FY 2019
<u>Beginning Fund Balance</u>	256.478	47.564	57.886
OBPP Revenue Estimate	2,141.479	2,233.266	2,336.240
Transfers-In (SB 261)		31.640	1.640
Transfers-In 65th Legislature OTO		6.370	
**Temp Revenue Enhancements to Offset Fire Costs		14.648	30.084
**Other Legislative Actions		32.310	18.597
Federal Tax Reform		(7.600)	(12.300)
Prior Year Revenue Adjustments	(2.111)		
Total Funds Available	2,395.846	2,358.198	2,432.147
<u>General Appropriations Act</u>			
HB 2 Disbursements (Adjusted for SB 261)	2,004.574	1,986.310	2,033.305
**17-7-140, MCA Reductions		(32.603)	(44.105)
<u>Non-HB 2 Disbursements</u>			
HB 1 - Feed Bill	8.239	2.210	9.063
HB 3 - Supplemental	23.167	40.000	-
**Other Legislative Actions		(20.371)	(23.931)
<u>Other Disbursements</u>			
Statutory Appropriations	291.065	315.135	323.429
Transfers	32.090	20.108	20.693
Other Appropriations	5.602	1.661	(2.349)
Reversions		(7.238)	(7.296)
Prior Year Expenditure Adjustments	(4.058)		
Total Disbursements	2,360.679	2,305.212	2,308.809
Fund Balance Adjustments	12.397	4.900	
Ending Fund Balance	47.564	57.886	123.338
YOY Expenditure Growth		-2.35%	0.16%
Fund Balance as a % of Total Spend		2.51%	5.34%
"Cut-To" Target (Pre-November Special Session)			143.20
Trigger (Pre-November Special Session)			119.33
"Cut-To" Target (Post-November Special Session)			138.53
Trigger (Post-November Special Session)			115.44