

# Individual and Corporate Income Tax



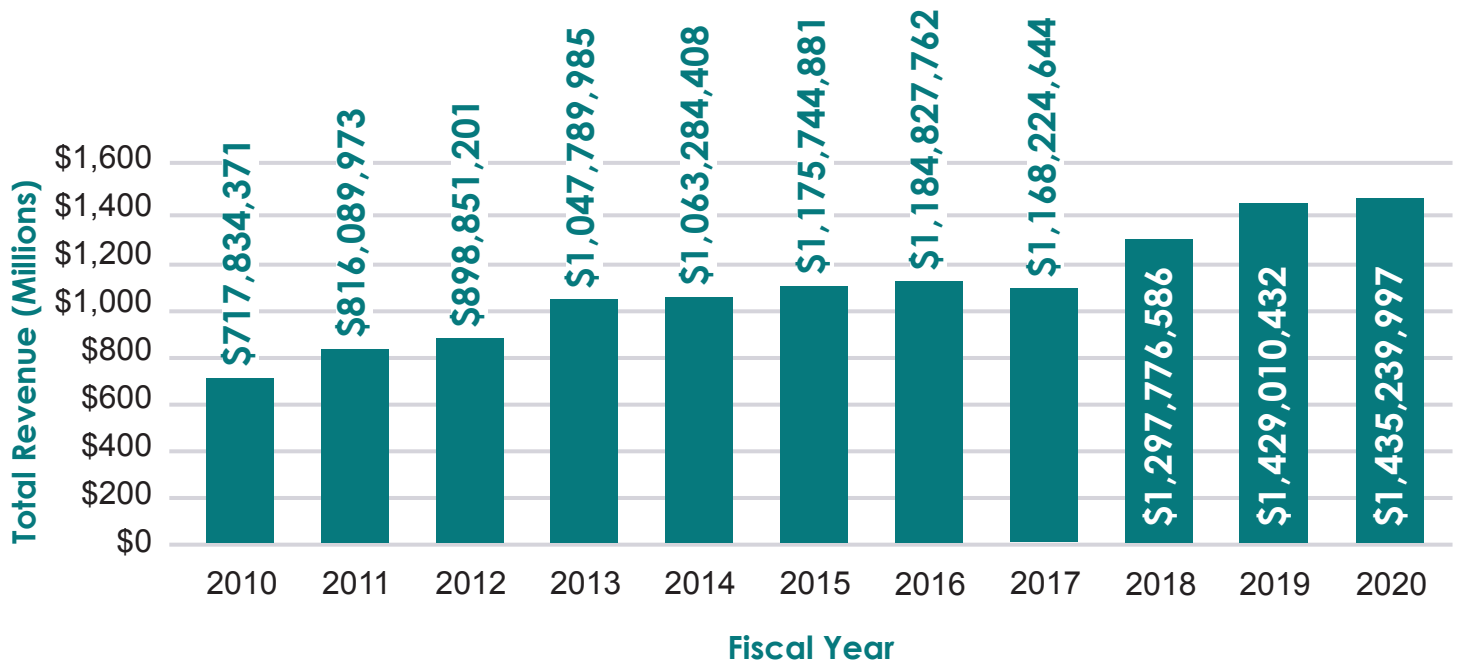
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# Individual Income Tax Overview

The individual income tax is the largest source of state tax revenue. All income tax revenue is allocated to the state general fund, accounting for 56.7 percent of general fund revenue for Fiscal Year 2020. Income tax revenue is collected primarily through withholding from wages and other periodic payments, quarterly estimated tax payments, and payments made when a return is filed. The following tables show income tax revenue and return filings.

## Individual Income Tax Collections



## Income Tax Returns and Refunds - Timely Filed Current Year Returns

Tax Year	Returns with Refund	Total Returns	Percent with Refund	Avg. Refund
2004	294,025	547,623	66%	\$468
2005	297,993	554,224	66%	\$491
2006	311,789	572,256	66%	\$464
2007	345,972	591,874	71%	\$506
2008	345,172	601,078	70%	\$598
2009	337,714	587,425	70%	\$545
2010	335,904	596,021	68%	\$532
2011	341,057	604,758	68%	\$538
2012	343,678	611,360	68%	\$523
2013	348,137	626,654	67%	\$532
2014	350,760	635,045	67%	\$536
2015	357,902	647,329	67%	\$546
2016	364,936	647,855	68%	\$578
2017	366,734	657,720	67%	\$591
2018	404,727	660,060	74%	\$504
2019	424,853	681,306	75%	\$535

*The way refunds were reported on returns changed in Tax Year 2018. In previous tax years, returns by married couples filing separately on the same form had their refund amounts combined and counted as a single return. Starting in Tax Year 2018, the refunds on these returns were separated and counted as two separate returns.*

# Individual Income Tax Overview

The Legislature enacted the income tax in 1933 and has made major changes infrequently. The latest change was enacted in 2003 (effective 2005). This change reduced the number of rates, lowered the top rate, capped the itemized deduction for federal taxes, and provided preferential treatment for capital gains income.

Most differences between the federal and Montana income tax structure reflect the legislative decisions to allow married couples to file separately in Montana when they file jointly for federal tax purposes and to use Montana-specific additions, subtractions, and deductions in determining Montana taxable income.

Federal law provides different rate tables for married couples who file joint and separate returns. Couples generally have lower federal tax if they file a joint return. Most states either require couples to make the same choice between joint and separate returns as they did for their federal taxes, have different rate tables for joint and separate returns, or have a single tax rate so that the choice does not matter. Montana is one of only five states that do not have at least one of these provisions. Because of this, most two-income married couples find their tax is lower if they file a joint federal return and separate Montana returns. This is because when they file separately, the spouses can apply the lower brackets of the tax table twice on their combined income, instead of only once when they file jointly.

Montana also is one of only six states that allow a deduction for federal income taxes. Montana and two other states have a cap on the deduction, while the deduction is uncapped in three states. Most states do not allow this deduction because not having it allows lower rates. To raise the same revenue, a state that allows the deduction must have higher rates to compensate for the smaller tax base. The 2003 Legislature partially offset the revenue reduction from lower rates by capping the deduction for federal taxes.

Before 1981, the Legislature occasionally adjusted rate tables and other tax parameters for the effects of inflation. The 1981 Legislature assigned this task to the department. Each year the department adjusts rate brackets, standard deductions, personal exemptions, and the partial exemption for pension income for inflation. This prevents increases in individual tax liabilities that are due simply to inflation. Without this inflation adjustment, a person whose income just kept up with inflation would pay higher effective tax rates over time as inflation moved them to higher rate brackets.

# Recent Legislative Changes to Individual Income Tax

The following bills passed by the 2017 Legislature affected the individual income tax:

- HB 42** Changed the due date for partnership returns from the 15th day of the fourth month after the end of the tax year to the 15th day of the third month.
- HB 63** Changed the filing date for informational returns from February 28 to January 31. These returns document taxable income and taxes withheld.
- HB 137** Removed references to the Insure Montana tax credit from the state's statutes. It also extended the Securities Restitution Assistance Fund end date to July 1, 2021.
- HB 175** Increased the deduction for contributions to Medical Savings Accounts from \$3,000 to \$3,500 in Tax Year 2018 and \$4,000 for 2019. The bill also requires the amount to be adjusted for inflation each tax year after 2019 and limits contributions to the Medical Savings Accounts to the deductible amount. It also changed Medical Savings Accounts to allow the funds to be withdrawn for long-term care, long-term care insurance, and family leave expenses.
- HB 308** Created a non-refundable tax credit for employers who participate in an apprenticeship program registered with the Department of Labor and Industry. The credit is \$750 per apprentice and \$1,500 per veteran apprentice and became available to employers in Tax Year 2018.
- HB 391** Created a State Earned Income Tax Credit of 3 percent of the federal Earned Income Tax Credit. The credit is fully refundable and became available starting Tax Year 2019.
- HB 498** Extended the termination date of the unlocking state lands credit from the end of Tax Year 2020 to the end of 2027.
- HB 511** Revised the Multistate Tax Compact to allow the market sourcing of sales when apportioning the Montana source income of some pass-through businesses.
- HB 574** Allowed some individual income taxpayers to deduct wages, salaries, or business expenses from Montana income when the expenses cannot be deducted at the federal level, due to the taxpayer claiming a credit.
- HB 597** Created a deduction for taxpayers on their income taxes for donations made to the state's public land access network grant program.
- SB 10** Repealed the income tax credit for residential property tax on a principal residence.
- SB 138** Extended the time a taxpayer can claim an income tax refund to one year after the overpayment or filing of the income tax return.
- SB 252** Expanded, to certain second-tier pass-through entities, the waiver from the requirement to file a composite return or withholding tax.

The following bills passed by the 2019 Legislature affected the individual income tax:

- HB 88** Allowed income to be deducted for contributions to Achieving a Better Life Experience (ABLE) accounts that are held out-of-state.
- HB 211** Allowed taxpayers who receive loan repayment assistance from the Quality Educator Loan Assistance Program to subtract the assistance from their adjusted gross income.
- HB 293** Created the Montana Economic Development Industry Advancement (MEDIA) credit for film and other production. Credit is based on total base investment within the state, production expenditures, and post-production wages, and increases for expenditures in underserved areas. Credit is capped at \$10 million total each calendar year.
- HB 320** Provided an exemption from claims or creditors for assets held in, or distributed from, a Family Education Savings Account or an ABLE account.
- SB 111** Extended the termination date of the Qualified Endowment Tax Credit from Tax Year 2019 to the end of Tax Year 2025.
- SB 207** Allowed taxpayers to deposit an income tax refund into an education savings or ABLE account on their income tax return.
- SB 337** Expanded the facilities that can claim the Alternative Energy Production Credit to include at least 1 megawatt of electrical energy installed on dams that otherwise would not produce power.

See previous Biennial Reports for legislative history prior to 2017.

# Calculation of Individual Income Tax

Calculation of Montana individual income tax begins with the taxpayer's Federal Adjusted Gross Income. Several adjustments are made to determine Montana Adjusted Gross Income:

- Income taxed by the state but exempted by the federal government is added.
- Income exempted by the state but taxed by the federal government is subtracted.
- Deposits to Montana tax-advantaged savings accounts are subtracted.
- Taxable withdrawals from Montana tax-advantaged savings accounts are added.
- Net adjustments from filing a joint federal return and separate state returns are added.
- Recoveries of costs deducted in previous years (primarily refunds of federal taxes previously deducted) are added.

The values of the taxpayer's exemptions and either itemized or standard deductions are subtracted from Montana Adjusted Gross Income to determine Montana taxable income. The state's standard deduction amount is set at 20 percent of the taxpayer's Montana Adjusted Gross Income, with minimum and maximum deduction amounts set. The value of exemptions and maximum and minimum standard deductions are adjusted for inflation each year.

## Personal Income Tax Exemptions and Deductions

Tax Year	Exemption Amount	Single and Separate Returns		Joint Returns	
		Min. Standard Deduction	Max. Standard Deduction	Min. Standard Deduction	Max. Standard Deduction
2016	\$2,380	\$1,980	\$4,460	\$3,960	\$8,920
2017	\$2,410	\$2,000	\$4,510	\$4,000	\$9,020
2018	\$2,440	\$2,030	\$4,580	\$4,060	\$9,160
2019	\$2,510	\$2,090	\$4,710	\$4,180	\$9,420
2020	\$2,560	\$2,130	\$4,790	\$4,260	\$9,580



# Income, Deductions, Credits, and Tax Liability

Tax liability is calculated from the rate table. The rate table shows tax rates to apply to taxable income, or income after making all federal and state adjustments and subtracting exemptions and deductions. The rate table is adjusted for inflation each year. The following tables show the upper limit on taxable income subject to each rate and the number of full-year resident returns with taxable incomes that qualify for each tax rate. Non-resident and partial-year resident returns are not included in the table below and all the following tables in this section. This is due to a significant portion of the income reported on these returns not being taxable by the state.

## Marginal Tax Rate Income Limits

Tax Year	2016	2017	2018	2019	2020
1.0%	\$2,900	\$2,900	\$3,000	\$3,100	\$3,100
2.0%	\$5,100	\$5,200	\$5,200	\$5,400	\$5,500
3.0%	\$7,800	\$7,900	\$8,000	\$8,200	\$8,400
4.0%	\$10,500	\$10,600	\$10,800	\$11,100	\$11,300
5.0%	\$13,500	\$13,600	\$13,900	\$14,300	\$14,500
6.0%	\$17,400	\$17,600	\$17,900	\$18,400	\$18,700
6.9%	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited

## Tax Year 2019 Full-Year Resident Returns

Tax Rate	Primary Return	Spouse Return	Total	% Total
0.0%	82,306	9,136	91,442	15.5%
1.0%	26,288	3,534	29,822	5.0%
2.0%	18,523	3,315	21,838	3.7%
3.0%	23,600	4,480	28,080	4.7%
4.0%	23,044	5,025	28,069	4.7%
5.0%	24,529	5,563	30,092	5.1%
6.0%	29,524	7,518	37,042	6.3%
6.9%	256,244	68,638	324,882	54.9%
Total	484,058	107,209	591,267	100.0%

Any credits the taxpayer may claim are subtracted from the tax liability to give the net tax. Non-refundable credits can partially or completely offset a taxpayer's tax liability. Refundable credits can more than offset a taxpayer's tax liability, so that the taxpayer receives a payment from the state general fund rather than paying tax. Taxpayers with capital gains income are allowed a non-refundable credit equal to 2 percent of their capital gains. In effect, this credit reduces the taxes on capital gains to a maximum rate of 4.9 percent, compared to the maximum rate of 6.9 percent for other types of income. Other credits generally are a percentage of a certain type of qualifying expenditure the taxpayer has made.

The next six tables show information about individual line items on timely-filed full-year residents' income tax returns for Tax Years 2018 and 2019. For each line item, the table shows the count of the number of returns with a value on that line and the sum of those values. The total in each count's column is the number of returns with a number on at least one line.

Information in these tables is from unaudited returns as filed by taxpayers. It does not reflect changes or adjustments that taxpayers or the department may make after the extension filing deadline. It also does not include information from late-filed returns.

# Montana Individual Income Tax

## Income Reported on Full-Year Residents' Returns - 2018 and 2019

Income Items	2018		2019	
	Count	Total	Count	Total
Wage and Salary Income	443,400	\$17,994,376,390	454,393	\$19,085,634,781
Taxable Interest Income	197,441	\$306,499,866	208,428	\$417,757,845
Ordinary Dividend Income	119,778	\$657,997,503	124,299	\$979,447,204
Taxable Refunds of State/Local Income Taxes	91,198	\$96,622,268	17,406	\$16,256,972
Alimony Received	746	\$14,846,155	599	\$14,755,881
Business Income (Schedule C)	79,995	\$832,408,301	82,450	\$974,387,706
Capital Gains Income	116,358	\$1,942,201,352	122,050	\$2,491,694,849
Ordinary Income Gains	16,313	\$146,109,741	16,221	\$150,090,730
IRA Income - Taxable Amount	138,880	\$3,403,718,606	66,876	\$1,060,917,391
Pension and Annuity Income - Taxable Amount			110,439	\$2,572,250,304
Rent, Royalty, Partnership, etc. Income	98,407	\$2,119,778,141	101,826	\$2,882,134,961
Farm Income	17,625	(\$292,435,886)	17,684	(\$333,067,682)
Unemployment Compensation	19,899	\$80,750,167	19,820	\$82,795,091
Taxable Social Security Benefits	98,636	\$1,148,731,687	104,780	\$1,284,200,662
Other Income	31,982	(\$571,208,760)	32,151	(\$564,557,977)
<b>Total Income</b>	<b>570,058</b>	<b>\$27,880,395,529</b>	<b>586,970</b>	<b>\$31,114,673,780</b>

Federal Adjustments to Income	2018		2019	
	Count	Total	Count	Total
Educator Expenses	10,123	\$2,389,412	10,413	\$2,474,403
Business Expenses	877	\$2,949,432	771	\$2,612,284
Health Savings Account Deduction	12,490	\$41,366,481	13,396	\$45,824,799
Moving Expenses	263	\$502,723	323	\$598,850
One-Half Self-Employment Tax	63,511	\$85,230,666	65,888	\$96,409,633
Self-Employed SEP, SIMPLE, and Qual. Plans	2,344	\$41,034,938	2,615	\$51,970,436
Self-Employed Health Insurance Deduction	22,375	\$139,368,732	23,058	\$148,882,955
Penalty on Early Withdrawal of Savings	1,891	\$518,244	1,772	\$736,269
Alimony Paid	1,063	\$17,484,829	930	\$17,895,060
IRA Deduction	14,008	\$60,604,691	14,014	\$63,021,981
Student Loan Interest Deduction	49,991	\$46,949,461	50,056	\$48,349,339
Tuition and Fee Deduction	0	\$0	3,871	\$8,888,960
<b>Total Adjustments to Income</b>	<b>139,295</b>	<b>\$443,054,961</b>	<b>144,534</b>	<b>\$491,912,412</b>
<b>Federal Adjusted Gross Income</b>	<b>570,078</b>	<b>\$27,437,340,569</b>	<b>587,050</b>	<b>\$30,622,786,306</b>

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## Montana Individual Income Tax Additions Reported on Full-Year Residents' Returns - 2018 and 2019

Montana Additions to Federal Adjusted Gross Income	2018		2019	
	Count	Total	Count	Total
Taxable Federal Refunds	79,541	\$110,230,309	53,082	\$80,618,443
Recoveries of Amounts Deducted in Earlier Years	184	\$442,945	257	\$373,100
Interest on Other States' Municipal Bonds	18,527	\$70,739,186	19,794	\$96,561,068
Dividends Not Included in Federal Adjusted Gross Income	838	\$450,209	895	\$466,351
Adjustment for Smaller Federal Estate and Trust Taxable Distributions	105	\$311,352	200	\$790,762
Medical Savings Account Nonqualified Withdrawals	192	\$348,943	231	\$426,060
First-Time Homebuyer's Account Nonqualified Withdrawals	10	\$31,301	16	\$17,465
Allocation of Compensation to Spouse	287	\$5,013,436	310	\$5,398,137
Federal Net Operating Loss Carryover	5,276	\$615,109,935	6,069	\$619,319,297
Dependent Care Assistance Credit Adjustment	38	\$73,125	70	\$150,066
Farm and Ranch Risk Management Account Taxable Distributions	*	\$3,443	*	\$6,293
Federal Taxes Paid by Your S Corporation	57	\$150,990	164	\$531,569
Title Plant Depreciation and Amortization	*	\$25	*	\$13
Other Additions	1,973	\$16,644,230	1,773	\$10,374,795
Addition to Taxable Social Security Benefits	9,787	\$17,749,604	10,059	\$18,118,699
<b>Total Montana Additions</b>	<b>106,396</b>	<b>\$837,094,385</b>	<b>83,737</b>	<b>\$833,120,879</b>

\*Not disclosed due to confidentiality concerns

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# Montana Individual Income Tax

## Subtractions Reported on Full-Year Residents' Returns - 2018 and 2019

Montana Subtractions from Federal Adjusted Gross Income	2018		2019	
	Count	Total	Count	Total
State Tax Refunds Included in Federal Adjusted Gross Income	90,945	\$96,274,735	17,182	\$16,053,866
Federal Bonds Exempt Interest	23,434	\$31,134,949	26,628	\$47,045,746
Elderly Interest Exclusion	83,935	\$36,035,566	89,775	\$41,744,457
Larger Federal Estate and Trust Taxable Distributions	525	\$2,680,457	536	\$3,055,140
Exempt Income of Child Taxed to Parent	166	\$429,180	132	\$393,519
Recoveries of Amounts Deducted in Earlier Years	67	\$237,419	44	\$117,097
Exempt Unemployment Compensation	19,899	\$80,750,167	19,820	\$82,795,091
Exempt Tribal Income	6,095	\$238,297,833	5,922	\$230,915,588
Exempt Tip Income	20,399	\$81,593,214	22,048	\$88,982,140
Exempt Worker's Comp Benefits	185	\$1,111,653	156	\$882,827
Exempt Health Insurance Premiums Taxed to Employee	151	\$743,590	133	\$550,391
Student Loan Repayments Taxed to Health Care Professional	461	\$1,422,858	479	\$1,535,563
Exempt Active Duty Military Salary	4,897	\$198,113,363	5,247	\$214,409,324
Exempt Life Insurance Premiums Reimbursement (National Guard)	15	\$17,792	22	\$34,481
Medical Care Savings Account Exempt Deposits	6,856	\$19,589,251	7,186	\$22,651,337
First-Time Homebuyer Exempt Savings Account Deposits	265	\$731,601	280	\$753,212
Family Education Savings Account Exempt Deposits	5,686	\$13,454,571	6,296	\$15,038,959
ABLE Account Exempt Deposits	86	\$171,910	124	\$242,259
Subtraction for Spouse Filing Joint Return: Capital Loss Adjustment	440	\$885,627	324	\$933,981
Subtraction for Spouse Filing Joint Return: Passive Loss Carryover	76	\$621,161	179	\$1,362,812
Allocation of Compensation to Spouse	287	\$5,013,436	310	\$5,398,137
Montana Net Operating Loss Carryover	4,681	\$510,426,578	5,870	\$585,477,718
Business Expense of Recycled Material	107	\$938,108	112	\$617,354
Wage Deduction Reduced by Federal Targeted Jobs Credit	65	\$589,177	284	\$2,304,272
Medical Marijuana Provider Expenses	58	\$982,343	62	\$4,306,185
Sales of Land to Beginning Farmers	*	\$3,955	*	\$33,234
Capital Gains from Small Business Investment Companies	17	\$79,928	24	\$10,486
Certain Gains Recognized by Liquidating Corporation	0	\$0	*	\$198,419
Farm and Ranch Risk Management Accounts Exempt Deposits	*	\$1,154	0	\$0
Donation of Mineral Exploration Information	*	\$1,476	*	\$715
Gain on Eligible Sale of Mobile Home Park	0	\$0	*	\$1,506,856
Passthrough Subtractions Reported on K-1	0	\$0	488	\$3,822,260
Exempt Retirement Disability Income (under age 65)	38	\$161,933	28	\$115,731
Subtraction for Federal Taxable Tier II Railroad Retirement	3,228	\$52,442,866	3,196	\$53,205,289
Exempt Pension Income	46,857	\$174,904,162	47,656	\$182,365,023
Subtraction to Federal Taxable Social Security/Tier 1 Railroad Retirement	44,885	\$209,461,679	47,282	\$232,823,623
<b>Total Montana Subtractions</b>	<b>244,390</b>	<b>\$1,759,303,692</b>	<b>202,384</b>	<b>\$1,841,683,092</b>

\*Not disclosed due to confidentiality concerns

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# Montana Individual Income Tax Deductions Reported on Full-Year Residents' Returns - 2018 and 2019

Deductions	2018		2019	
	Count	Total	Count	Total
Deductible Medical Expenses	56,630	\$305,327,291	53,691	\$297,489,660
Medical Insurance Premiums Not Deducted Elsewhere	116,959	\$520,492,426	117,747	\$507,233,583
Long-Term Care Insurance Premiums	12,263	\$28,930,381	12,200	\$29,512,592
<b>Federal Income Tax</b>				
Federal Income Tax Withheld**	266,373	\$1,872,214,262	252,686	\$1,871,052,699
Federal Income Tax Estimated Payments**	46,157	\$597,154,276	49,776	\$817,709,158
Last Year's Federal Income Tax Paid (e.g. with return)**	67,870	\$457,650,599	68,121	\$609,615,209
Federal Income Tax from Previous Years**	3,652	\$18,423,317	1,895	\$7,652,418
<b>Total Federal Income Tax Deduction</b>	<b>293,287</b>	<b>\$1,199,661,055</b>	<b>280,719</b>	<b>\$1,153,558,682</b>
State or Local Sales Tax	490	\$432,273	456	\$419,587
Local Income Taxes	551	\$278,573	546	\$239,736
Real Estate Taxes	217,237	\$535,606,789	217,143	\$582,358,801
Personal Property Taxes	154,569	\$53,869,207	147,637	\$53,788,168
Combined State and Local Tax Deduction	236,259	\$553,904,721	234,203	\$589,498,152
Montana Light Vehicle Registration Fee	35,272	\$8,020,495	36,545	\$8,148,599
Per Capita Livestock Fee	591	\$66,935	581	\$81,369
Other Deductible Taxes	9,950	\$3,901,158	7,860	\$3,372,436
Home Mortgage Interest	157,012	\$903,558,507	156,781	\$987,393,435
Investment Interest	6,943	\$35,605,093	7,209	\$41,266,474
Contributions by Cash or Check	154,503	\$447,461,011	149,644	\$494,466,799
Contributions Other than Cash or Check	69,241	\$73,875,268	62,778	\$126,426,919
Carryover of Contributions from Previous Years	2,702	\$33,969,667	2,474	\$30,647,375
Child and Dependent Care Expenses	384	\$886,905	340	\$705,164
<b>Deductions</b>				
Casualty and Theft Losses	457	\$4,442,831	331	\$1,560,011
Political Contributions	9,769	\$939,555	8,326	\$780,893
Gambling Losses	1,460	\$18,712,466	1,420	\$22,720,462
Other Miscellaneous Deductions	2,127	\$6,464,034	1,976	\$15,410,097
<b>Total Itemized Deductions</b>	<b>321,490</b>	<b>\$4,147,710,325</b>	<b>314,612</b>	<b>\$4,310,272,702</b>
Standard Deductions	247,225	\$1,000,131,650	271,893	\$1,138,161,928
<b>Total Deductions</b>	<b>568,715</b>	<b>\$5,147,841,975</b>	<b>586,505</b>	<b>\$5,448,434,630</b>

\*\*Items either are part of another line or include another line. They are not part of the total.

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# Montana Individual Income Tax

## Exemptions, Taxable Income, Tax, and Payments Reported on Full-Year Residents' Returns - 2018 and 2019

Exemptions <sup>A</sup>	2018		2019	
	Count	Total	Count	Total
Self Exemption	-	574,798	-	591,267
Self 65 and Over Exemption	-	125,705	-	133,715
Self Blind Exemption	-	1,027	-	1,036
Total Taxpayer Exemptions	574,789	701,521	591,267	726,018
Spouse Exemption	-	82,270	-	83,181
Spouse 65 and Over Exemption	-	21,477	-	26,354
Spouse Blind Exemption	-	182	-	176
Total Spouse Exemptions	82,270	107,428	83,181	109,711
Dependent Exemptions	130,502	237,349	131,733	239,629
<b>Total Exemptions</b>	<b>574,789</b>	<b>1,046,298</b>	<b>591,267</b>	<b>1,075,358</b>
Value of Exemptions	-	\$2,548,411,640	-	\$2,699,138,540
<b>Taxable Income</b>				
Federal Adjusted Gross Income	570,078	\$27,437,340,569	587,050	\$30,622,786,306
+Montana Additions	106,396	\$837,094,385	83,737	\$833,120,879
-Montana Subtractions	244,390	\$1,759,303,692	202,384	\$1,841,683,092
-Deductions	568,715	\$5,147,841,975	586,505	\$5,448,434,630
-Value of Exemptions	572,922	\$2,548,411,640	591,267	\$2,699,138,540
<b>Montana Taxable Income</b>	<b>485,883</b>	<b>\$20,157,115,781</b>	<b>591,238</b>	<b>\$21,466,650,923</b>
<b>Tax Liability Before Credits</b>				
Tax from Tax Table	485,354	\$1,147,946,045	499,360	\$1,323,526,274
Tax on Lump Sum Distributions	10	\$1,152	22	\$2,375
Recapture of Credits Claimed Previously	*	\$4,556	12	\$4,461
<b>Total Tax</b>	<b>-</b>	<b>\$1,147,951,753</b>	<b>-</b>	<b>\$1,323,533,110</b>
<b>Payments</b>				
Montana Income Tax Withheld from Wages	459,285	\$917,243,999	472,619	\$984,931,541
Estimated Tax Payments	42,326	\$174,067,440	47,339	\$228,267,970
Overpayment Applied from Previous Tax Year	19,884	\$32,708,474	20,318	\$44,680,583
Withholding from Pass-through Entities	1,122	\$1,775,864	1,126	\$4,268,239
Other Payments	906	\$3,235,735	9,080	\$52,842,543
<b>Total Payments</b>	<b>523,523</b>	<b>\$1,129,031,512</b>	<b>550,482</b>	<b>\$1,314,990,876</b>

<sup>A</sup>Taxpayers claim exemptions for themselves and their spouses by checking boxes on the return. The counts for exemptions show the number of returns where the taxpayer claimed at least one exemption for themselves, their spouse, or dependents. The totals column shows the number and type of exemptions claimed. For the taxpayer and spouse, the totals column shows the numbers of basic exemptions and extra exemptions for being 65 or over or blind. For dependent exemptions, the count is the number of returns claiming at least one dependent, and the total is the number of dependents claimed.

Contact the department at (406) 444-6900 for a large-print copy of this table.

# Montana Individual Income Tax Credits Reported on Full-Year Residents' Returns - 2018 and 2019

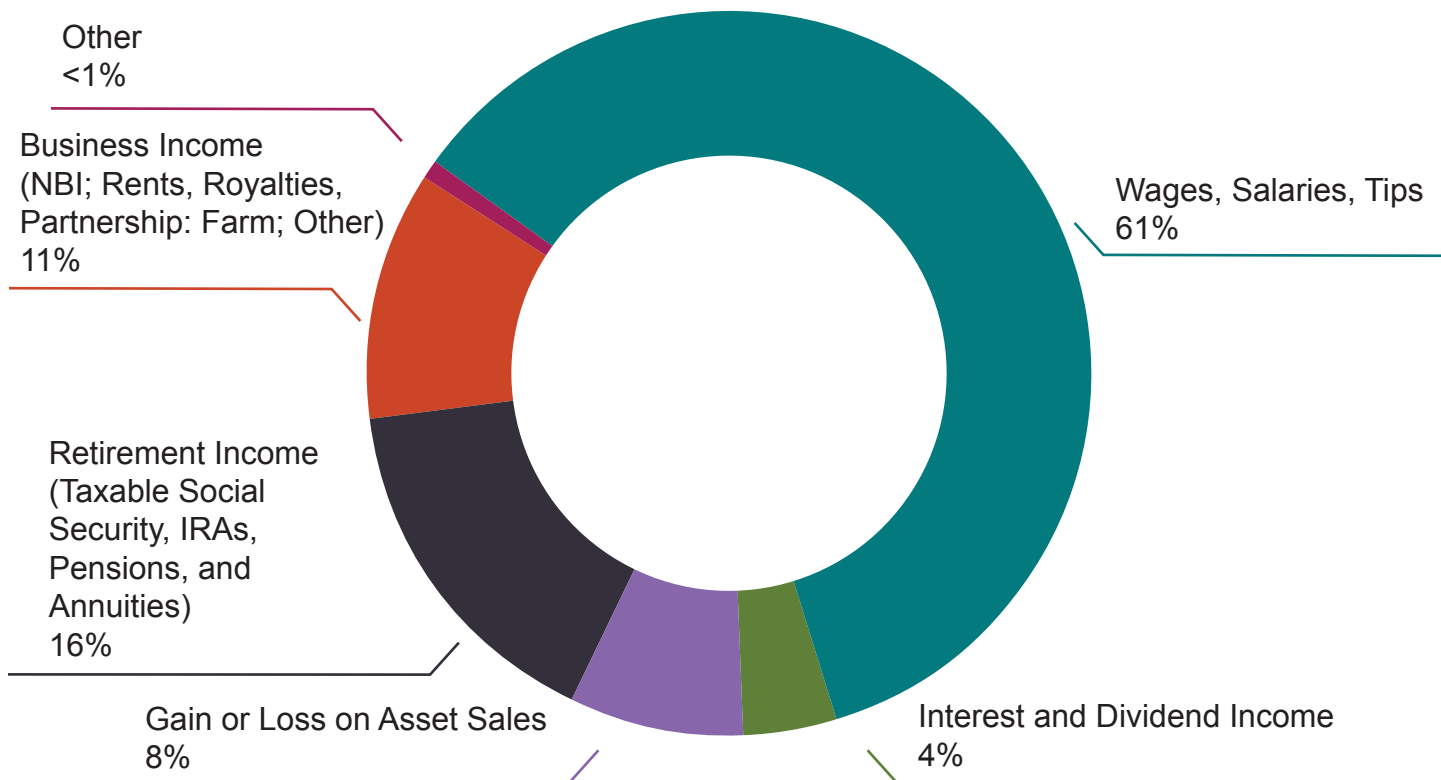
Credits Non-Refundable and No Carryover	2018		2019	
	Count	Total	Count	Total
Capital Gains Income Tax Credit	87,324	\$39,822,120	90,098	\$50,825,618
Other States' Income Tax Credit	14,893	\$31,680,581	15,816	\$44,613,482
College Contribution Tax Credit	2,733	\$270,911	2,862	\$306,088
Qualified Endowment Tax Credit	680	\$2,528,221	753	\$3,007,492
Energy Conservation Tax Credit	9,893	\$4,194,979	9,142	\$3,919,022
Alternative Fuel Tax Credit	19	\$13,431	22	\$13,933
Insurance for Uninsured Montanan's Credit	64	\$192,024	89	\$74,895
Elderly Care Tax Credit	64	\$99,933	57	\$75,800
Recycling Tax Credit	101	\$545,086	89	\$426,741
Innovation Education Credit	23	\$3,700	10	\$1,650
Student Scholarship Organization Credit	66	\$10,301	11	\$1,560
Apprenticeship Credit	153	\$154,603	271	\$294,451
<b>Non-Refundable with Carryover</b>				
Biodiesel Blending/Storage Tank Credit	*	\$5,030	0	\$0
Contractor's Gross Receipts Tax Credit	631	\$6,683,235	635	\$6,862,009
Geothermal Systems Tax Credit	91	\$90,729	100	\$107,789
Alternative Energy Systems Credit	535	\$301,311	726	\$408,041
Biomass Alternative Energy Systems Credit	333	\$173,974	349	\$194,382
Alternative Energy Production Tax Credit	*	\$7,266	12	\$64,474
Dependent Care Assistance Credit	11	\$77,311	14	\$24,634
Historic Property Preservation Tax Credit	20	\$27,884	22	\$36,554
Infrastructure User Fee Credit	20	\$6,427,077	*	\$5,019,787
Empowerment Zone Credit	0	\$0	0	\$0
Research Activities Tax Credit	*	\$1,303	*	\$26
<b>Non-Refundable with Carryover</b>				
Mineral Exploration Tax Credit	0	\$0	0	\$0
Adoption Credit	192	\$179,974	183	\$182,016
<b>Total Non-Refundable Credits</b>	<b>106,895</b>	<b>\$93,491,902</b>	<b>109,981</b>	<b>\$116,461,570</b>
<b>Refundable Credits</b>				
Earned Income Tax Credit	0	\$0	67,892	\$4,240,321
Elderly Homeowner/Renter Tax Credit	14,465	\$7,559,148	15,229	\$8,051,148
Emergency Lodging Credit	18	\$6,019	0	\$0
Unlocking State Lands Credit	*	\$100	*	\$7,500
<b>Total Refundable Credits</b>	<b>*</b>	<b>\$7,565,267</b>	<b>*</b>	<b>\$12,297,469</b>
<b>Total Credits</b>	<b>-</b>	<b>\$101,057,169</b>	<b>-</b>	<b>\$128,759,039</b>

\*Not disclosed due to confidentiality concerns

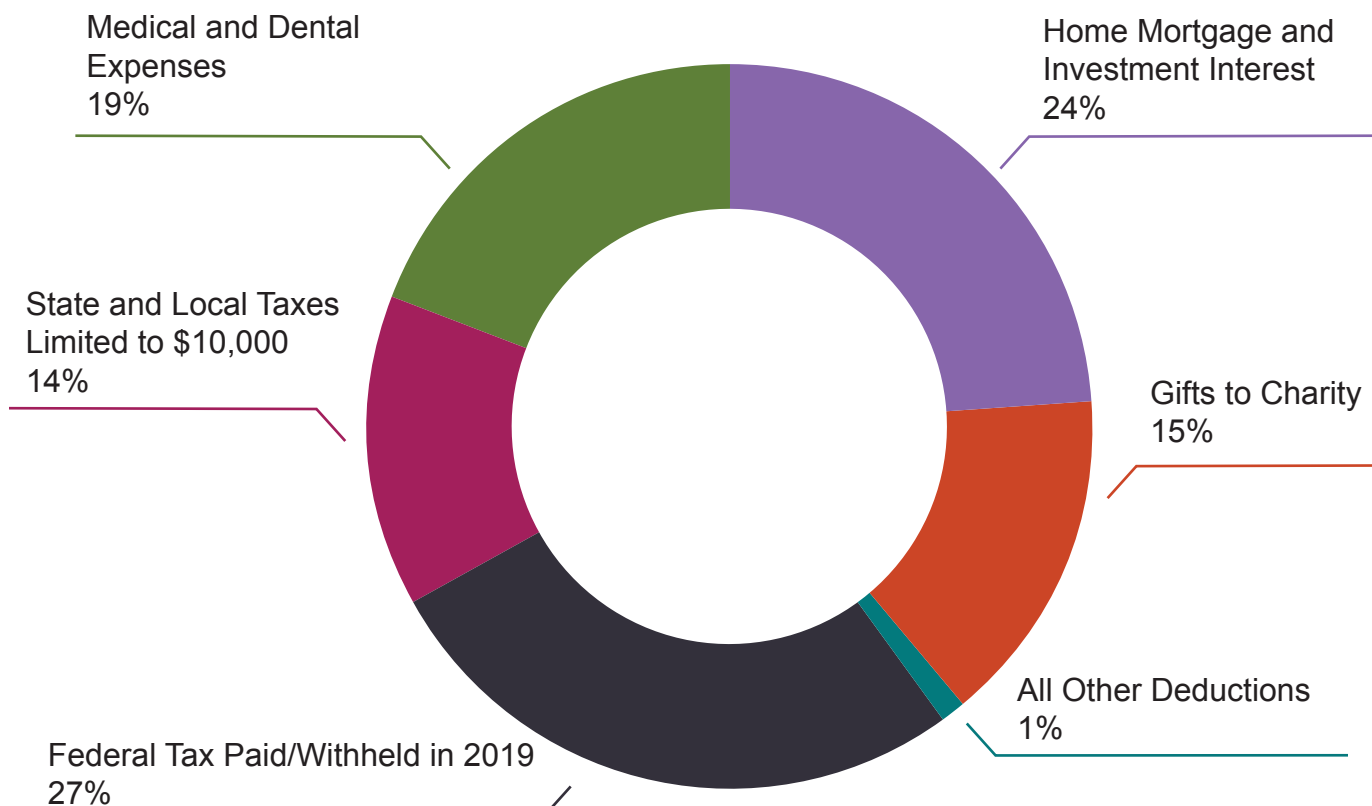
Contact the department at (406) 444-6900 for a large-print copy of this table.



## Breakdown of Income Sources - Tax Year 2019



## Breakdown of Itemized Deductions - Tax Year 2019



The following tables show Montana Adjusted Gross Income, deductions, taxable income, and tax liability by decile group for full-year Montana residents. Each decile is 10 percent of the population of full year resident returns, sorted by adjusted gross income. Group 1 is the 10 percent with the lowest incomes, while Group 10 is the 10 percent with the highest incomes. In these tables, married couples who file separate returns on the same form are counted as two returns and their income and tax are counted separately. Non-residents and part-year residents are not included because their tax depends on the fraction of income that is apportioned to Montana, which varies widely for these individuals.

## Deciles of Montana Adjusted Gross Income - Full-Year Residents - 2018 and 2019

Income Group	Returns	Income Range	2018		Returns	Income Range	2019	
			Montana Adjusted Gross Income				Montana Adjusted Gross Income	
			\$ million	% of total			\$ million	% of total
1st Decile	57,479	less than \$4,331	(\$604.3)	(2%)	59,126	less than \$4,352	(\$706.7)	(2%)
2nd Decile	57,480	\$4,331 to \$10,873	\$439.3	2%	59,127	\$4,352 to \$11,113	\$459.0	2%
3rd Decile	57,480	\$10,874 to \$17,402	\$809.7	3%	59,127	\$11,114 to \$17,971	\$856.3	3%
4th Decile	57,480	\$17,403 to \$24,441	\$1,201.8	5%	59,126	\$17,972 to \$25,304	\$1,278.8	4%
5th Decile	57,480	\$24,442 to \$31,981	\$1,616.9	6%	59,127	\$25,305 to \$33,093	\$1,721.0	6%
6th Decile	57,479	\$31,982 to \$40,787	\$2,086.7	8%	59,127	\$33,094 to \$42,125	\$2,219.2	7%
7th Decile	57,480	\$40,788 to \$51,149	\$2,631.3	10%	59,126	\$42,126 to \$52,907	\$2,797.1	9%
8th Decile	57,480	\$51,150 to \$65,173	\$3,316.2	13%	59,127	\$52,908 to \$67,592	\$3,532.4	12%
9th Decile	57,480	\$65,174 to \$91,874	\$4,402.9	17%	59,127	\$67,593 to \$96,084	\$4,710.2	16%
10th Decile	57,480	more than \$91,874	\$10,614.7	40%	59,127	more than \$96,084	\$12,746.9	43%
Top 5%*	28,740	more than \$124,939	\$7,575.2	29%	29,564	more than \$133,497	\$9,453.9	32%
Top 1*	5,748	more than \$293,532	\$3,573.8	13%	5,913	more than \$332,979	\$4,924.1	17%
Top 0.1%*	575	more than \$9,795,547	\$1,200.7	5%	592	more than \$1,262,939	\$2,009.7	7%
All	574,798	-	\$26,515.1	-	591,267	-	\$29,614.2	-

\*Included in 10th Decile

## Deductions by Decile Group - Full-Year Residents - 2018 and 2019

Income Group	% Returns Itemize	2018				% Returns Itemize	2019			
		Itemized Deductions		Standard Deductions			Income Range		Standard Deductions	
		\$ million	avg.	\$ million	avg.		\$ million	avg.	\$ million	avg.
1st Decile	34%	\$148.5	\$7,685	\$88.2	\$2,312	31%	\$145.9	\$8,006	\$101.8	\$2,489
2nd Decile	29%	\$110.5	\$6,516	\$95.7	\$2,362	28%	\$109.7	\$6,596	\$103.1	\$2,426
3rd Decile	36%	\$193.0	\$9,409	\$114.0	\$3,085	33%	\$151.2	\$7,697	\$125.4	\$3,177
4th Decile	36%	\$170.8	\$8,310	\$154.5	\$4,184	34%	\$174.1	\$8,643	\$168.4	\$4,320
5th Decile	40%	\$196.1	\$8,495	\$166.1	\$4,828	37%	\$198.9	\$9,074	\$184.8	\$4,966
6th Decile	52%	\$277.3	\$9,270	\$147.0	\$5,334	48%	\$278.2	\$9,722	\$166.4	\$5,456
7th Decile	71%	\$437.1	\$10,637	\$102.7	\$6,266	66%	\$432.2	\$11,151	\$127.4	\$6,254
8th Decile	84%	\$593.5	\$12,318	\$66.2	\$7,117	81%	\$603.2	\$12,585	\$79.9	\$7,136
9th Decile	89%	\$752.7	\$14,652	\$45.5	\$7,455	87%	\$778.7	\$15,090	\$56.6	\$7,527
10th Decile	95%	\$1,268.1	\$23,180	\$20.1	\$7,260	95%	\$1,438.2	\$25,725	\$24.3	\$7,534
Top 5%*	97%	\$794.2	\$28,513	\$6.3	\$7,085	97%	\$941.0	\$32,877	\$6.9	\$7,292
Top 1*	98%	\$286.9	\$50,816	\$0.7	\$6,601	98%	\$380.3	\$65,503	\$0.7	\$6,867
Top 0.1%*	99%	\$93.3	\$163,987	\$0.0	\$7,633	98%	\$154.9	\$265,777	\$0.1	\$7,327
All	57%	\$4,147.7	\$12,735	\$1,000.1	\$4,015	54%	\$4,310.3	\$13,496	\$1,138.2	\$4,186

\*Included in 10th Decile

## Deductions as Percent of Montana Adjusted Gross Income Full-Year Residents - 2018 and 2019

Income Group	2018			2019		
	Itemized Deductions	Standard Deductions	All	Itemized Deductions	Standard Deductions	All
1st Decile	(37%)	(44%)	(39%)	(32%)	(40%)	(35%)
2nd Decile	83%	31%	47%	83%	32%	46%
3rd Decile	67%	22%	38%	53%	22%	32%
4th Decile	40%	20%	27%	40%	20%	27%
5th Decile	30%	17%	22%	31%	17%	22%
6th Decile	25%	15%	20%	26%	15%	20%
7th Decile	23%	14%	21%	23%	13%	20%
8th Decile	21%	12%	20%	21%	12%	19%
9th Decile	19%	10%	18%	19%	10%	18%
10th Decile	12%	5%	12%	12%	5%	11%
Top 5%*	11%	4%	11%	10%	3%	10%
Top 1*	8%	1%	8%	8%	1%	8%
Top 0.1%*	8%	0.6%	8%	8%	0%	8%
All	20%	18%	19%	19%	18%	18%

*\*Included in 10th Decile*



## Taxable Income and Tax - Full-Year Residents - 2018 and 2019

Income Group	2018						2019					
	Taxable Income			Tax Liability			Taxable Income			Tax Liability		
	\$ mill.	avg.	% of Total	\$ mill.	avg.	% of Total	\$ mill.	avg.	% of Total	\$ mill.	avg.	% of Total
1st Decile	\$0.4	\$6	0%	(\$1.6)	(\$28)	0%	\$0.3	\$5	0%	(\$3.4)	(\$58)	0%
2nd Decile	\$117.5	\$2,045	1%	\$1.2	\$20	0%	\$121.1	\$2,049	1%	\$1.2	\$21	0%
3rd Decile	\$359.5	\$6,254	2%	\$7.0	\$122	1%	\$382.3	\$6,465	2%	\$7.5	\$127	1%
4th Decile	\$662.8	\$11,530	3%	\$19.2	\$333	2%	\$712.2	\$12,046	3%	\$20.8	\$352	2%
5th Decile	\$1,032.5	\$17,964	5%	\$39.9	\$694	4%	\$1,108.3	\$18,744	5%	\$43.1	\$729	3%
6th Decile	\$1,428.6	\$24,854	7%	\$65.6	\$1,141	6%	\$1,529.3	\$25,864	7%	\$70.6	\$1,194	6%
7th Decile	\$1,844.8	\$32,095	9%	\$93.5	\$1,627	8%	\$1,975.8	\$33,416	9%	\$100.7	\$1,703	8%
8th Decile	\$2,392.5	\$41,624	12%	\$130.6	\$2,271	12%	\$2,569.6	\$43,458	11%	\$140.9	\$2,383	11%
9th Decile	\$3,316.9	\$57,705	16%	\$192.7	\$3,353	17%	\$3,572.7	\$60,425	16%	\$208.6	\$3,528	16%
10th Decile	\$9,001.6	\$156,604	45%	\$560.1	\$9,745	51%	\$10,944.4	\$185,099	48%	\$682.7	\$11,546	54%
Top 5%*	\$6,608.3	\$229,934	33%	\$414.7	\$14,430	37%	\$8,334.7	\$281,920	36%	\$523.4	\$17,705	41%
Top 1%*	\$3,253.6	\$566,037	16%	\$204.7	\$35,618	18%	\$4,505.6	\$761,985	20%	\$282.5	\$47,769	22%
Top 0.1%*	\$1,106.2	\$1,923,900	5%	\$66.9	\$116,304	6%	\$1,851.1	\$3,126,807	8%	\$112.3	\$189,645	9%
All	\$20,157.1	\$35,068	-	\$1,108.1	\$1,928	-	\$22,915.8	\$38,757	-	\$1,272.7	\$2,152	-

\*Included in 10th Decile

## Tax as Percent of Montana Adjusted Gross Income Full-Year Residents - 2018 and 2019

Income Group	2018			2019		
	Adjusted Gross Income	Tax Liability	Tax/Income	Adjusted Gross Income	Tax Liability	Tax/Income
	\$ million	\$ million	%	\$ million	\$ million	%
1st Decile	(\$604.3)	(\$1.6)	0.3%	(\$706.7)	(\$3.4)	0.5%
2nd Decile	\$439.3	\$1.2	0.3%	\$459.0	\$1.2	0.3%
3rd Decile	\$809.7	\$7.0	0.9%	\$856.3	\$7.5	0.9%
4th Decile	\$1,201.8	\$19.2	1.6%	\$1,278.8	\$20.8	1.6%
5th Decile	\$1,616.9	\$39.9	2.5%	\$1,721.0	\$43.1	2.5%
6th Decile	\$2,086.7	\$65.6	3.1%	\$2,219.2	\$70.6	3.2%
7th Decile	\$2,631.3	\$93.5	3.6%	\$2,797.1	\$100.7	3.6%
8th Decile	\$3,316.2	\$130.6	3.9%	\$3,532.4	\$140.9	4.0%
9th Decile	\$4,402.9	\$192.7	4.4%	\$4,710.2	\$208.6	4.4%
10th Decile	\$10,614.7	\$560.1	5.3%	\$12,746.9	\$682.7	5.4%
Top 5%*	\$7,575.2	\$414.7	5.5%	\$9,453.9	\$523.4	5.5%
Top 1%*	\$3,573.8	\$204.7	5.7%	\$4,924.1	\$282.5	5.7%
Top 0.1%*	\$1,200.7	\$66.9	5.6%	\$2,009.7	\$112.3	5.6%
All	\$26,515.1	\$1,108.1	4.2%	\$29,614.2	\$1,272.7	4.3%

\*Included in 10th Decile

The table below breaks down the returns based on the Montana Adjusted Gross Income reported on the returns. Unlike the previous tables which broke down the returns into equal categories, the number of returns in each of the categories below is uneven, with a larger number of returns in the lower income categories and a smaller number of returns in the larger income categories.

## Tax Year 2019 Returns by Montana Adjusted Gross Income

Adjusted Gross Income	Primary Return	Spouse Return	Total	% Total
Less Than \$0	20,632	3,158	23,790	4.0%
Between \$0 and \$50,000	305,423	69,976	375,399	63.5%
Between \$50,000 and \$100,000	110,794	27,072	137,866	23.3%
Between \$100,000 and \$150,000	26,510	4,111	30,621	5.2%
Between \$150,000 and \$200,000	8,265	1,258	9,523	1.6%
Between \$200,000 and \$250,000	3,839	576	4,415	0.7%
Between \$250,000 and \$300,000	2,273	304	2,577	0.4%
Between \$300,000 and \$350,000	1,469	195	1,664	0.3%
Between \$350,000 and \$400,000	917	100	1,017	0.2%
Between \$400,000 and \$450,000	755	107	862	0.1%
Between \$450,000 and \$500,000	533	59	592	0.1%
More than \$500,000	2,648	293	2,941	0.5%
<b>Total</b>	<b>484,058</b>	<b>107,209</b>	<b>591,267</b>	<b>100.0%</b>

# Taxation of Business Income

## Business Structure and Taxation

A legal ownership structure of a business generally determines how income from the business is taxed. Business organization is a matter of state law. A business operating in Montana may be organized under the laws of Montana (generally Title 35, Montana Code Annotated) or of the laws of another state. States vary somewhat in the options for business organization they allow and in the details of particular business structures.

While tax considerations may affect a business's choice of ownership structure, there are other factors that may have a larger influence. Different business structures give the owners different types of protection from or exposure to the business's legal and financial liabilities. They have different mechanisms for decision making and control of the business's operations and different arrangements for sharing of income, expenses, risks and rewards among the owners. Business structures offer different levels of privacy or transparency of ownership. How a business is organized can also affect its ability to access capital markets. Most corporations and some types of partnerships can raise funds by issuing new shares. Existing shares can be bought and sold without requiring the other owners' consent. With other business structures, buying and selling ownership interests or raising funds by bringing in new owners may require the other owners' consent.

For taxation, the Internal Revenue Code puts all businesses in one of three categories. Montana law generally requires a business to be in the same category for state taxation as it is for federal taxation.

### Individuals/Sole Proprietors

Informally organized sole proprietor businesses are not treated as an entity separate from the owner for income tax reporting purposes. The owner of a sole proprietor business must be an individual or a married couple. Some formally organized businesses with a single owner are not sole proprietor businesses and are treated as separate from the owner for income tax reporting purposes. These businesses are called disregarded entities and are subject to filing a Montana information return and income tax withholding paid on behalf of the owner. The disregarded entity's income is still reported on the owner's tax return and is taxed as part of the owner's income. If the disregarded entity pays income tax on behalf of the owner. The owner can claim the payment as a refundable credit.

### Pass-Through Entities

Partnerships, limited liability companies, and other unincorporated businesses with more than one owner generally are treated as pass-through entities. A corporation with no more than 100 shareholders, with a single class of stock, and with no shareholders that are another business entity or a nonresident alien, may elect to be treated as a pass-through entity. Such a corporation is known as an S Corporation because its taxation is laid out in Subchapter S of Chapter 1 of the Internal Revenue Code.

For a pass-through entity, there is no tax on income at the business entity level. The entity calculates its net income and each owner's share of that net income. The owners must include that income (or loss) in the calculation of their taxable income. An owner's income from a pass-through entity is a share of the business's income, not the payments the owner receives from the business.



If a pass-through entity retains part of its income to finance expansion or other investment, each owner is taxed on their share of the retained income, and the accounting value of each ownership interest is increased by the owner's share of the retained income. If the pass-through pays out more than its annual net income, the excess is treated as a return of a portion of the owner's investment. It is not taxed, and the accounting value of each ownership interest is reduced by the owner's share of the excess distribution.

A pass-through entity is required to file an annual information return showing the calculation of its net income or loss and the distribution of that income or loss to owners. The owners are then responsible for reporting this income on their tax returns and including it in the calculation of their taxable income. If a pass-through entity has a nonresident or second-tier pass-through entity owner, then the pass-through must include the owner in a composite return, withhold income tax on behalf of the owner, or obtain a waiver of these requirements.

## C Corporations

A corporation that does not meet the requirements to be treated as a pass-through entity, or that does not choose pass-through treatment, is taxed on income at the business entity level. The corporation calculates its net income and is taxed on it at the corporate income tax rate. The corporation's income is not directly attributed to the owners. A corporation's owners must include dividends they receive in the calculation of their taxable incomes. A corporation may pay dividends that are more or less than its net income. If it does, there is no adjustment to the accounting value of individual shares. This allows a corporation to retain profits for reinvestment without the shareholders being taxed on those profits.

The table on the next two pages shows characteristics of businesses falling into each of the four business tax categories.

## Business Structure and Taxation

	Sole Proprietor	Pass-Through Entity (S Corporation or Partnership)	C Corporation	Disregarded Entity
<b>Legal Business Organization</b>	Informal	Partnership, Limited Liability Company (LLC), Corporation, Limited Partnership, etc.	Corporation	Single Member LLC, etc.
<b>May Be Owned By</b>	Individual or Married Couple	Individuals or Other Business Entities	Individuals or Other Business Entities	Individuals or Other Business Entities
<b>Business Income and Owner's Income</b>	The business net income is all attributed to the owner.	The business calculates its net income, and this income is attributed to the owners.	The business calculates its net income. Owners' income is dividends received.	The business net income is all attributed to the owner.
<b>Distribution of Income to Owners</b>	The business net income is the owners' income from the business.	Distributions to owners need not equal businesses' current net income.	Business pays dividends to shareholders. Dividends need not equal businesses' current net income.	Distribution to owner need not equal businesses' current net income.
<b>Taxation</b>	Owner reports income from business as part of income subject to individual income tax.	No tax at the entity level. Owners responsible for tax on income attributed to them.	Business net income subject to corporation income tax. Owners taxed on dividends.	Entity is ignored. Businesses' income is taxed as owner's income.

## Business Structure and Taxation

	Sole Proprietor	Pass-Through Entity (S Corporation or Partnership)	C Corporation	Disregarded Entity
Reporting	The business receipts and costs are reported on Schedule C of the owners' federal tax return (Schedule F for a farm), and net income is reported on Line 12 for Business Income or Loss (Line 18 for Farm Income or Loss) of the state return.	The business files federal and state information returns. Federal return shows receipts and costs and both show income, deductions, and credits passed through to owners. Owners report their share of net business income from the pass-through as business income (Schedule E and Line 17 of the tax return for individuals). If the business receives dividends, capital gains, or other passive income, owners report those separately on the appropriate return lines.	The business files federal and state corporate income tax returns and a federal information report, Form 1099-DIV, for each owner who received at least \$10 of dividends. Owners report dividends received on their tax returns (Line 9 of state return for individuals).	Income is reported on owner's return.  Information return required if owner is a non-resident or another business.

## Business Structure, Tax Administration, and Compliance

Taxation of business income can be complicated when a business operates in more than one taxing jurisdiction and when one business entity is partly or completely owned by another. When a business operates in more than one taxing jurisdiction, it is necessary to decide how much of the business's income is taxable by each jurisdiction. When one business entity owns another or two businesses have a common owner, it can be necessary to decide how much of the common income is due to each business. When affiliated businesses operate across multiple jurisdictions the complications are compounded.

A general principle that most U.S. states and most countries follow is that business income should be taxable by the jurisdiction where the business activity that created the income took place and should not be taxable by other jurisdictions. This is often called the source principle of income taxation.<sup>1</sup>

<sup>1</sup> The source principle of income taxation contrasts with the destination principle of consumption taxation. U.S. states and most countries follow the principle that taxes on consumptions, such as sales taxes, should be levied by the jurisdiction where the goods or services are used rather than by jurisdictions where they are made or sold.

When a business operates in more than one taxing jurisdiction, each must decide how much of the business's income has its source in that jurisdiction. For example, suppose a company harvests timber and mills it into lumber in Montana and sells the lumber in North Dakota. The company receives all its gross income in North Dakota and pays most of its costs in Montana. Its net income, which is the basis of taxation in both Montana and North Dakota, is due to the combined operation in both states.

Each state decides how much of the combined net income to tax through a process called apportionment. Each state uses a formula to determine an apportionment factor, the portion of the company's business income<sup>2</sup> to attribute to operations in the state. Montana uses the equally-weighted three-factor apportionment formula where the apportionment factor is the average of the proportions of a company's property, payroll, and sales in a state. Other states use a range of formulas. Some place more weight on one factor and less weight, or no weight, on the others.

If lumber production in Montana and lumber sales in North Dakota were separate, unrelated businesses, there would be no need for apportionment. The lumber production company's net income would be the difference between its receipts from selling lumber wholesale and its costs of harvesting timber and milling lumber. This net income would be taxable by Montana. The lumber sales company's net income would be the difference between its receipts from retail lumber sales and its costs of buying the lumber wholesale and operating its lumber yards. This net income would be taxable by North Dakota.

If the two companies are affiliates, such as two separate legal entities both owned by a third company, the situation is more complicated. Apportionment is still needed because wholesale lumber sales from the mill in Montana to the yards in North Dakota are not arms-length transactions. The transfer prices at which the lumber mill sells to the lumberyards are not determined in a market and do not necessarily reflect the lumber's true value. From the point of view of the parent company, these transfer prices are irrelevant. The mill's revenue from wholesale sales and the lumberyard's expenses for wholesale purchases cancel each other out. The parent company's net income is the difference between the revenue from retail lumber sales and the costs of timber harvesting, lumber milling, and lumberyard operations.

Montana law addresses this problem through combined reporting. Affiliated companies that are not engaged in completely separate businesses are required to file a single, combined return and to apportion the group's income. The Montana timber harvesting and lumber milling company, the North Dakota lumber yard company, and their parent company would file a combined return and should pay the same Montana taxes as if they were a single company.

Another complication can arise when affiliated companies are pass-through entities and there is a tiered ownership structure, with a company that is actually conducting business being owned by a second-tier pass-through entity, which may be one of several owned by a third-tier pass-through entity, which may be a partnership owned by several fourth-tier pass-through entities, and so on.

<sup>2</sup> *Income that is not from a company's normal line of business, such as income from sale of some of a company's assets, generally is assigned to the state where the assets are located rather than being apportioned.*

As income is passed through this chain to the individuals who are the ultimate owners, its original source may be ignored. For example, a person in New York or California who is a partner in a company that owns other companies may be unaware that part of their income from this partnership ultimately comes from business operations in Montana. In that case, they are likely to overlook their obligation to pay income tax in Montana.

Montana law tries to address this problem by requiring pass-through entities with out-of-state owners either to have the out-of-state owners agree to file Montana tax returns, to withhold Montana tax for the out-of-state owners, or to file a composite return and pay Montana tax on behalf of its owners.

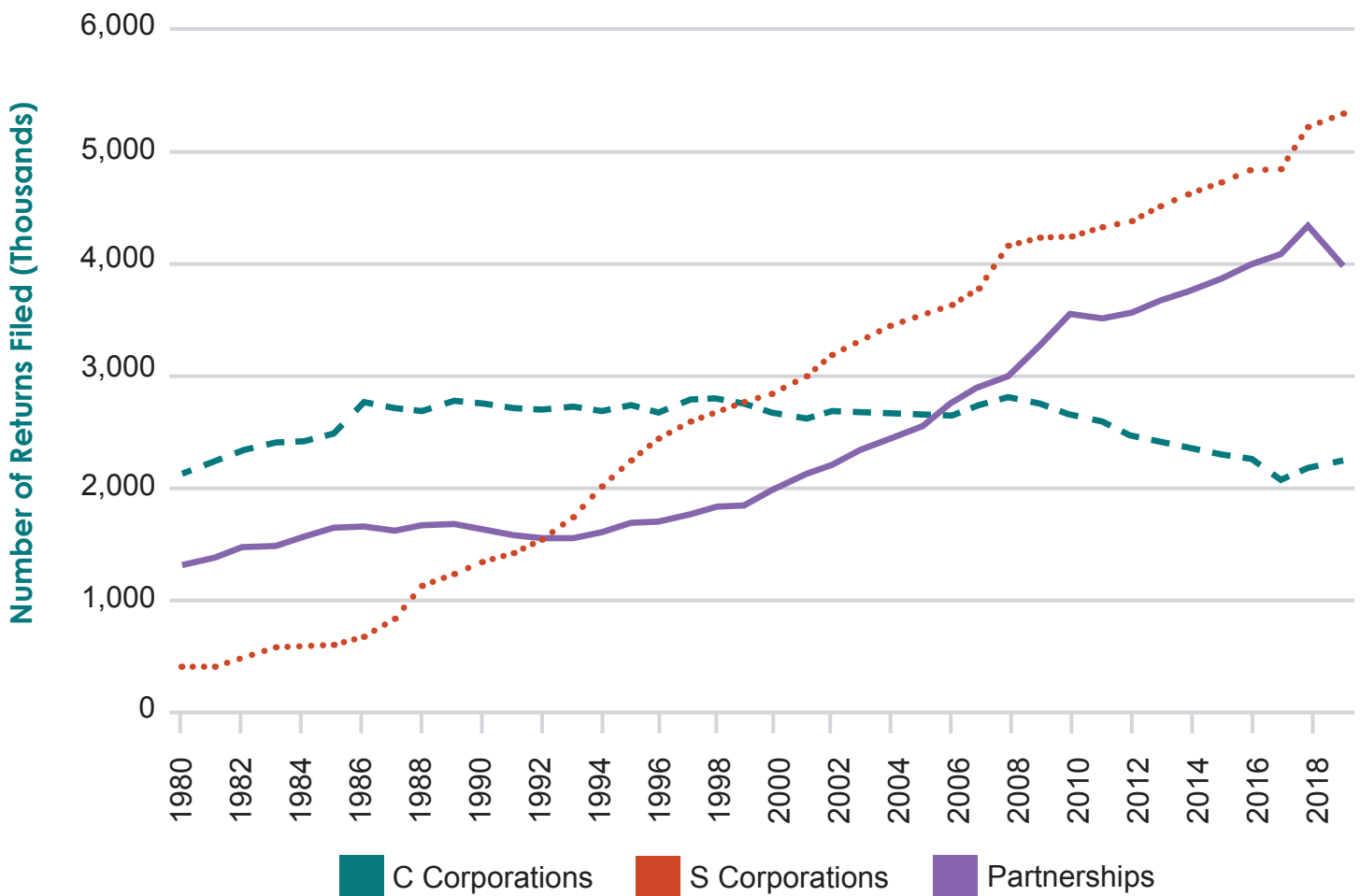
Montana law requires individual corporations and affiliated groups to report worldwide income and apportion a share to Montana, with one exception. A group of affiliated companies may make what is called a water's edge election. When a group makes this election it is only required to include affiliates in its combined report if the primary company owns at least half the stock and at least 20 percent of the affiliate's payroll and property is in the United States, the affiliate is one of several types of companies defined in federal law that only engage in international trade, the affiliate has gains or losses from selling U.S. real estate, or the affiliate is incorporated in one of the countries listed as tax havens in Montana law. A corporate group that makes the water's edge election is taxed at a rate of 7 percent rather than the normal rate of 6.75 percent.

# Pass-Through Entities

## Growth of Pass-Through Entities

Increasingly, in Montana and nationwide, business and investment activities are being conducted by pass-through entities. The graph below shows the number of returns filed with the IRS by C Corporations versus those filed by pass-through entities (partnerships and S Corporations) from 1980 through 2019. The graphs and history in this section are from the Internal Revenue Service's annual Data Book and other Statistics of Income Division reports.

## Number of U.S. C Corporation Returns Compared to S Corporation and Partnership Returns (Pass-Through Entities), 1980-2019

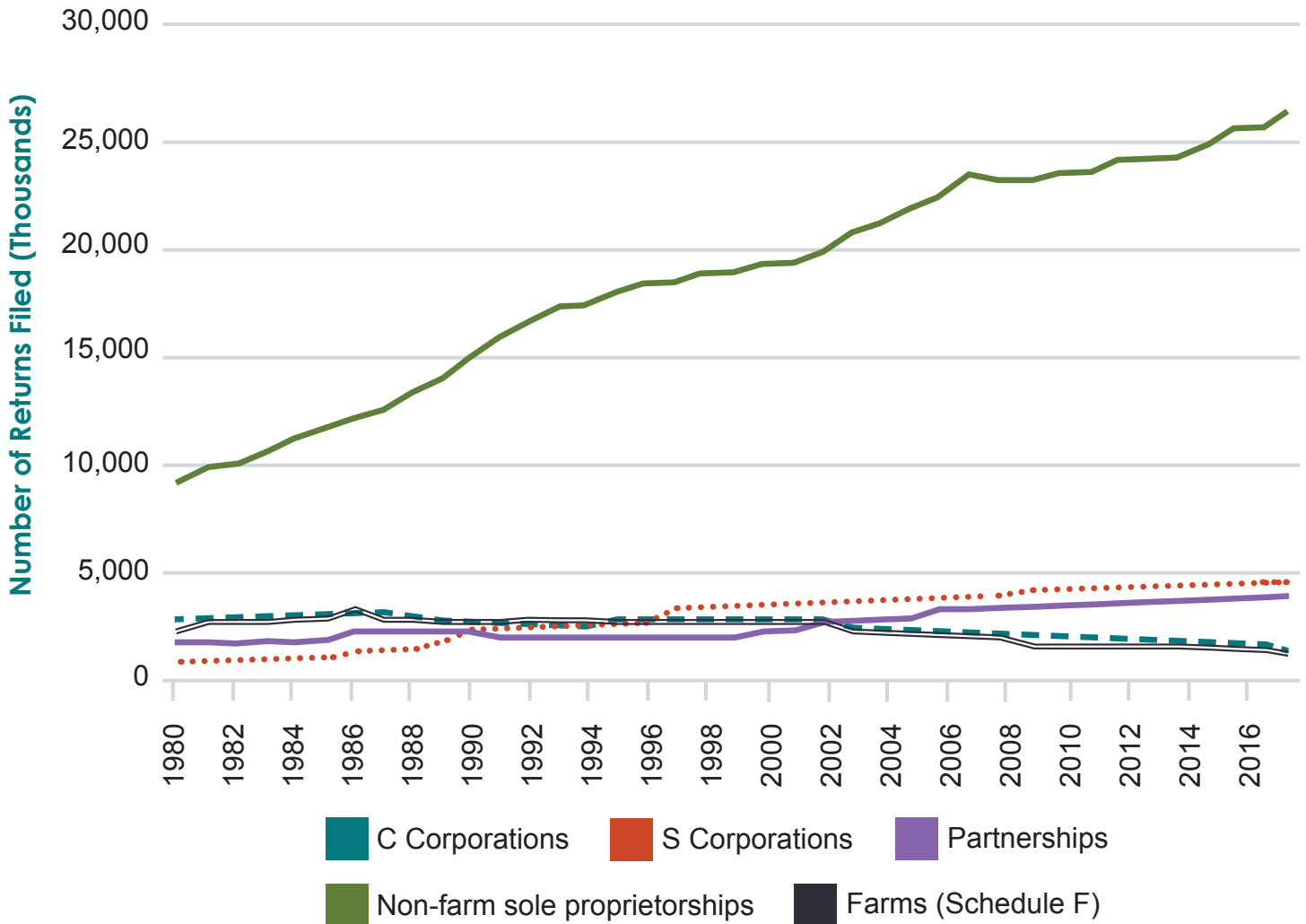


Over time, Congress has modified the rules governing pass-throughs, particularly S Corporations, making those business structures more attractive for business purposes. For example, the number of permitted shareholders has been expanded from the original 10 in 1958 to 35 in 1982, 75 in 1996, and 100 in 2004, where it remains today.



The graph below shows growth of all types of business organizations, including non-farm sole proprietorships, S Corporations, partnerships, and farms for Tax Years 1980 through 2017.

## Number of Different Types of Business Returns, 1980-2017 (IRS Statistics of Income)



As can be seen from the graph, non-farm sole proprietorships are the most common type of business entity in the United States based upon the number of returns filed. The number of non-farm sole proprietorships has grown substantially, from 9 million in 1980 to just over 26.4 million in 2017.

If the business owner has a farm or ranch operation that is operated as a sole proprietorship, the taxpayer reports his or her income on the farm income or (loss) line of the state individual income tax form and attaches a copy of their federal Schedule F, which they would have filed with their federal form. The number of farms filing under Schedule F is also shown on the graph. The total number of farms in the United States filing Schedule F declined from 2.6 million in 1980 to 1.79 million in 2017. However, it should be noted that farms can also operate as partnerships or be incorporated as S or C Corporations.

During the same period, the number of Corporation returns declined from 2.2 million in 1980 to 1.57 million in 2017. One thing to note is that C Corporations in Montana vary greatly in terms of size. There are large or very large businesses which engage in operations across many states and even countries, but there are also smaller firms that engage in agricultural operations, are Main Street businesses, or are regional operations. Some of these corporations may have been incorporated before the S Corporation structure was available. Others may have been incorporated as C Corporations in order to be better positioned to access capital markets, or for other advantages that C Corporation status provides.

The number of businesses that filed as S Corporations has also grown very rapidly during the same time. The IRS data shows the number grew from 545,000 in 1980 to over 4.7 million in 2017, an annual average growth rate of 6.2 percent. Partnerships grew more slowly, increasing from 1.4 million in 1980 to 3.9 million in 2017.

Although not shown on the graph, less common types of pass-through entities also increased over the last three decades. These include Real Estate Investment Trusts (REITs) and Regulated Investment Companies (RICs), better known as mutual funds, increasing from 1,691 returns in 1980 to 22,000 returns in 2017.

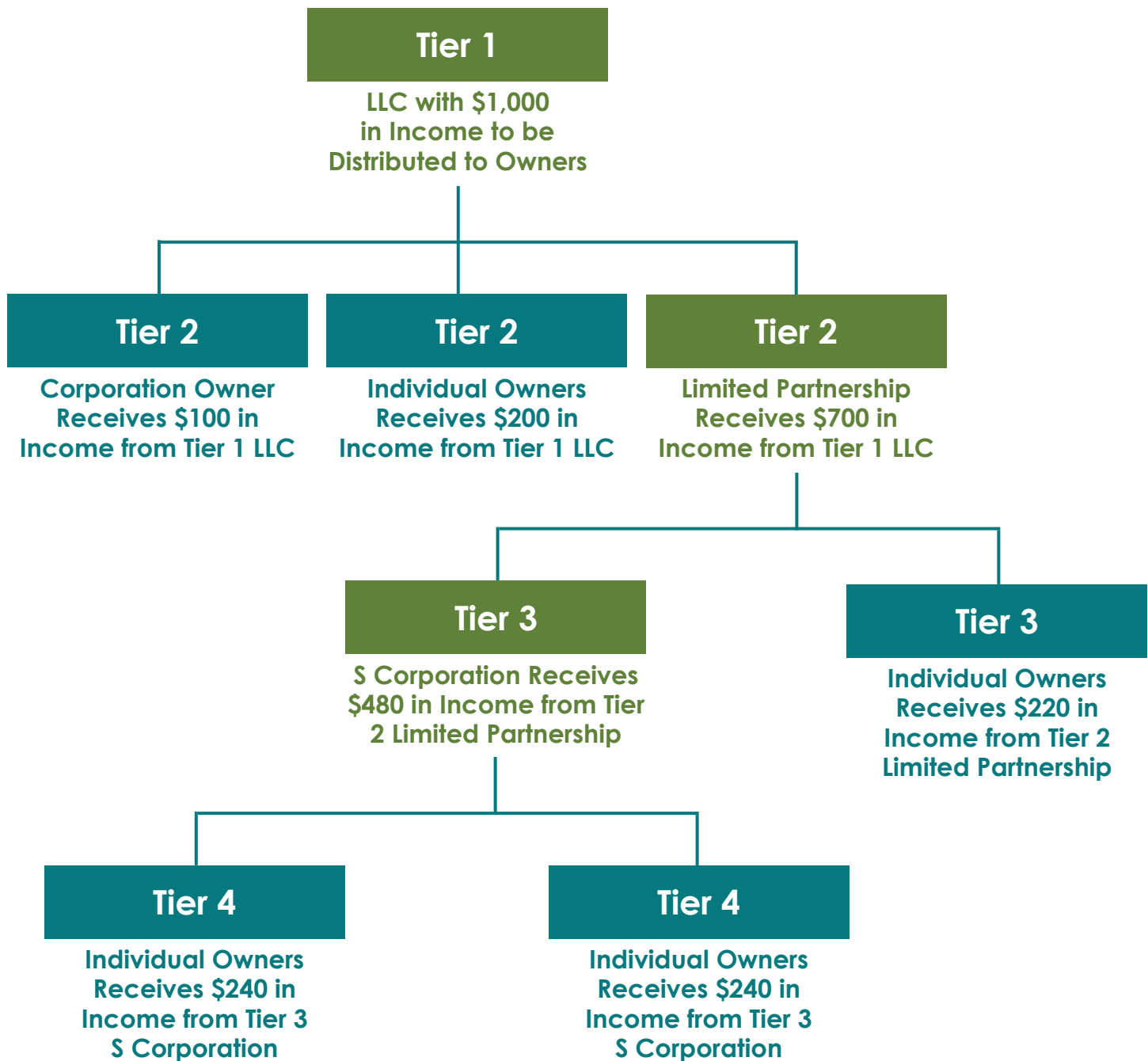
## Ownership, Income, Deductions, and Credits Reported on Montana Pass-Through Returns

Pass-through entities include partnerships; S Corporations; Limited Liability Companies (LLCs); Real Estate Investment Trusts (REITs); Regulated Investment Trusts (RITs), better known as mutual funds; and others. Partnerships are an old and familiar business entity, but S Corporations are less so. The S Corporation rules were enacted in 1958 and permit a corporation and its shareholders to elect to be taxed at one level.

The most common type of pass-through entity today is the Limited Liability Company, or LLC. LLCs are actually a creation of the states since state law generally governs business structure. The first LLC statute was enacted in Wyoming in 1977 and now all states and the District of Columbia have LLC statutes. However, for federal tax purposes, federal law governs the tax treatment (states generally follow the federal treatment). For taxation purposes LLCs are generally treated as partnerships, although LLCs with two or more members can elect to be treated as S Corporations. Any single member LLC can elect to be treated as a sole proprietorship if the single member is an individual. If the single member is a corporation, the LLC is treated as division of the corporation by the IRS. The taxpayer's state filing must be consistent with its federal filing, so if a business filed as an S Corporation at the federal level, it must file as an S Corporation at the state level.

A pass-through entity's income is not taxed. Instead, its income and expenses are reported on the tax returns of the owners. The owners can be corporations, individuals, other pass-through entities, or a mix of all of them. When pass-through entities are owned by other pass-through entities, a tiered business structure is created.

Tiered structures add complexity to tax administration because the taxpayer may be quite remote from the entity doing business in the state. Because pass-through entities can have a corporation, an individual, and/or another pass-through entity as a partner, owner or shareholder, they represent a challenge for tax administration. The diagram on the following page shows how complex a set of ownership, or partnership, relationships can become.



Pass-through entities classified as S Corporations or partnerships with Montana source income are required to file an information return each year. If this entity has a partner, shareholder, member, or other owner that is a non-resident individual, foreign C Corporation, or a pass-through entity with an owner or shareholder, that is a non-resident individual or foreign C Corporation; the pass-through entity is also required to file with the state an agreement with the individual non-resident to timely file a Montana return, pay taxes and be subject to personal jurisdiction of the state with respect to the income from a pass-through. If this agreement is not met, the pass-through entity must in all subsequent tax years withhold the appropriate amount and remit the tax payment directly to the state.

The pass-through information returns show the total amounts of various types of income, deductions, and credits allocated to the owners and the amount distributed to each owner. Pass-through entities operating in more than one state apportion part of their income to Montana using the same apportionment formula as C Corporations. Pass-through returns show the Montana source income allocated to each owner and indicate whether each owner is an individual or another business entity.

Owners of pass-through entities taxed as partnerships may be either individuals or business entities. Shares of S Corporations can only be owned by individuals, electing small business trusts or employee stock ownership plans. However, some types of passthrough entities that can be owned by other business entities can elect to be treated as S Corporations for tax purposes. The table below breaks out the number of owners reported on the 64,860 Montana pass-through returns by resident and nonresident.

## Shares of Pass-Through Owners by Residency Status

Type of Owner	Number	%
Resident Individuals	90,306	20%
Nonresident Individuals	234,310	53%
Montana Business Entities	6,360	1%
Non-Montana Business Entities	113,997	26%
<b>Total</b>	<b>444,973</b>	<b>100%</b>

Overall, individuals comprised 73 percent of the owners associated with Montana's pass-throughs, which is a slight increase from the 71 percent in 2016.

The following table shows the number of owners, by resident and non-resident, reported on the 64,860 Montana pass-through returns filed in 2018.

## Montana Pass-Through Owners by Residency Status and Pass-through Type

Type of Owner	S Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
	Owners	%	Owners	%	Owners	%	Owners	%
Resident Individuals	38,586	90%	3,330	10%	41,962	69%	6,428	2%
Nonresident Individuals	3,305	8%	25,856	78%	12,409	20%	192,740	63%
Montana Business Entities	568	1%	78	0%	3,835	6%	1,879	1%
Non-Montana Business Entities	252	1%	3,832	12%	2,958	5%	106,955	35%
<b>Total</b>	<b>42,711</b>	<b>100%</b>	<b>33,096</b>	<b>100%</b>	<b>61,164</b>	<b>100%</b>	<b>308,002</b>	<b>100%</b>

The next table shows the number of returns, types of income, Montana adjustments to income, and deductions that were reported on the pass-through informational returns in 2018.

## Montana-Source Income Passed Through to Owners – 2018

	S Corporations		Partnerships	
	Montana	Multi-State	Montana	Multi-State
<b>Returns</b>	24,884	8,589	19,973	10,272
<b>Income Items</b>				
Salaries and Other Fixed Payments to Owners	\$948	\$0	\$131,452,266	\$27,793,197
Ordinary Business Income	\$1,576,065,557	\$685,483,499	\$436,754,733	\$331,532,752
Rental Income				
Real Estate	\$26,730,115	\$4,938,675	\$121,292,165	\$14,604,099
Other	\$3,755,125	\$14,867,583	\$6,040,943	(\$11,568,816)
Interest	\$24,160,043	\$17,340,719	\$33,123,818	\$40,671,080
Dividends	\$7,370,033	\$4,923,942	\$21,955,178	\$9,850,911
Royalties	\$6,179,704	\$11,084,266	\$35,221,988	\$84,506,926
Capital Gains	\$61,247,067	\$98,379,287	\$74,009,901	\$54,868,942
Gains Taxed as Ordinary Income	\$161,275,077	\$67,307,604	\$165,767,323	\$308,229,291
Other Income	\$1,360,022	-\$1,691,974	\$45,660,305	\$11,059,713
<b>Total</b>	<b>\$1,868,143,691</b>	<b>\$902,633,601</b>	<b>\$1,071,278,620</b>	<b>\$871,548,095</b>
<b>Montana Additions to Federal Income</b>				
Interest on Non-Montana Municipal Bonds	\$2,935,916	\$255,584	\$2,906,752	\$1,590,852
State and Local Income Taxes	\$828,024	\$2,931,587	\$514,132	\$1,712,885
Other	\$2,390,475	\$804,227	\$267,033	\$59,252,943
<b>Total</b>	<b>\$6,154,415</b>	<b>\$3,991,398</b>	<b>\$3,687,917</b>	<b>\$62,556,680</b>

## Montana-Source Income Passed Through to Owners – 2018

	S Corporations		Partnerships	
	Montana	Multi-State	Montana	Multi-State
<b>Montana Subtractions from Federal Income</b>				
Interest on Federal Bonds	\$8,714,209	\$251,259	\$488,707	\$790,910
Purchases of Recycled Materials	\$306,201	\$117,745	\$4,831	\$5,417
Other	\$5,449,773	\$29,016,209	\$28,592,524	\$12,142,221
<b>Total</b>	<b>\$14,470,183</b>	<b>\$29,385,213</b>	<b>\$29,086,062</b>	<b>\$12,938,548</b>
<b>Deductions</b>				
IRC Section 179 Expense Deduction	\$94,772,631	\$24,450,981	\$24,323,908	\$6,840,655
Other Expense Deductions	\$51,438,312	\$143,812,999	\$120,749,787	\$401,737,343
<b>Total</b>	<b>\$146,210,943</b>	<b>\$168,263,980</b>	<b>\$145,073,695</b>	<b>\$408,577,998</b>
<b>Total Montana Source Income</b>	<b>\$1,713,616,980</b>	<b>\$708,975,806</b>	<b>\$900,806,780</b>	<b>\$512,588,229</b>



When there is tiered ownership, meaning one pass-through entity is a full or part owner of another, both entities will include the income the first-tier entity allocates to the second-tier entity in their returns. Because of this, the combined Montana source income of pass-through entities in the state is less than the combined amounts reported on the returns. The table below has the Montana source income reported on pass-through returns and the source income after second-tier entity income is removed for Tax Years 2014 through 2018.

## Montana Source Income Before and After Second-Tier Income is Removed

<b>Tax Year</b>	<b>Montana Source Income</b>	<b>Tier 2 Income</b>	<b>Net Montana Source Income</b>
2014	\$3,437,429,157	\$328,070,300	\$3,109,358,857
2015	\$3,149,660,193	\$220,997,348	\$2,928,662,845
2016	\$3,179,714,842	\$265,782,912	\$2,913,931,930
2017	\$3,601,564,076	\$721,374,374	\$2,880,189,702
2018	\$4,024,862,213	\$1,058,422,949	\$2,966,439,264

When a pass-through entity does something that is eligible for a tax credit, the credit is usually allocated to the owners. Owners then claim their share of the credit on their tax returns. However, sometimes owners may not be able to claim a credit that is allocated to them. For example, some credits can only be claimed by individuals. A corporation that owns part of a pass-through entity would not be able to claim those credits.

Some credits can only be used to reduce the current year's tax liability. Owners with no taxable income in the current year would not be able to claim these credits. Because of this, the credits actually claimed on owners' tax returns can be less than the credits reported on pass-through returns.

The next table shows credits reported on pass-through entity returns for 2018. Credits actually claimed by owners are included in the credits claimed against individual income tax and corporation income tax.

## Tax Credits Passed Through to Owners, 2018

Credit	S Corporations		Partnerships	
	Montana	Multi-State	Montana	Multi-State
Dependent Care Credit	\$0	\$0	\$1	\$230,199
College Contribution Credit	\$10,864	\$3,825	\$2,397	\$0
Insurance for Uninsured Montanans Credit	\$51,047	\$4,576	\$3,023	\$1,421
Credit for Investment in Recycling Equipment	\$478,578	\$13,549	\$85,543	\$0
Alternative Energy Production Credit	\$0	\$0	\$106,154	\$0
Contractor's Gross Receipts Credit	\$4,475,786	\$3,520,575	\$191,307	\$275,108
Alternative Fuel Credit	\$0	\$0	\$0	\$0
Infrastructure Users Fee Credit	\$5,465	\$4,230,022	\$1,177,073	\$84,791
Historic Building Preservation Credit	\$0	\$0	\$0	\$0
Mineral Exploration Credit	\$0	\$0	\$0	\$0
Empowerment Zone Credit	\$0	\$0	\$0	\$100
Biodiesel Blending Credit	\$0	\$0	\$0	\$0
Innovative Education Program Credit	\$0	\$0	\$0	\$0
Student Scholarship Organization Credit	\$0	\$0	\$0	\$0
Emergency Lodging Credit	\$0	\$0	\$0	\$0
Unlocking Public Lands Credit	\$0	\$0	\$2,250	\$0
<b>Total</b>	<b>\$5,021,740</b>	<b>\$7,772,547</b>	<b>\$1,567,748</b>	<b>\$591,619</b>

## Pass-through Distributions and Credits by Industry

When preparing an informational tax return, pass-through entities are expected to provide information on the type of industry work the pass-through is engaged in.<sup>1</sup> The next table provides a list of the Montana source income that was distributed by Montana's S Corporations in 2018, broken down by industry sector type. As this shows, there is a significant amount of variation in the amount of income S Corporations provided to their respective owners at the industry level. S Corporations in the Construction sector generated the largest amount of combined Montana source income for their owners, distributing approximately \$510 million in 2018. The Professional and Business Services sector and Trade, Transportation and Utilities sector also provided a significant amount of income to their owners, passing through \$492.6 million and \$471.5 million in income respectively.

## Montana-Source Income Passed Through to Owners - S Corporations - 2018 (Thousands of Dollars)

	Natural Res. and Mining	Construction	Manufacturing	Trade, Trans. and Utilities	Info.	Financial Activities	Pro. and Business Services	Ed. and Health Serv.	Leisure and Hospitality	Other Services	Unknown/ Public Admin.
<b>Returns</b>	3,149	6,378	1,254	4,977	422	4,582	6,208	2,058	2,466	1,835	144
<b>Income Items</b>											
Salaries and Other Fixed Payments to Owners	\$0	\$0	\$0	\$0	\$0	\$1	\$0	\$0	\$0	\$0	\$0
Ordinary Business Income	\$41,257	\$496,275	\$92,143	\$449,956	\$22,794	\$280,008	\$499,969	\$178,257	\$112,181	\$83,610	\$5,097
<b>Rental Income</b>											
Real Estate	\$9,307	(\$3,235)	\$648	\$3,850	\$246	\$17,058	\$492	\$326	\$2,416	\$405	\$155
Other	\$1,920	\$315	\$5,818	\$9,205	\$14	\$568	\$501	\$3	\$181	\$99	\$0
Interest	\$4,889	\$5,835	\$1,526	\$11,430	\$284	\$7,390	\$3,117	\$1,004	\$5,465	\$524	\$36
Dividends	\$2,035	\$883	\$2,894	\$3,307	\$228	\$1,745	\$673	\$62	\$275	\$191	\$1
Royalties	\$10,901	\$441	\$103	\$392	\$308	\$3,286	\$658	\$420	\$492	\$259	\$6
Capital Gains	\$12,299	\$13,571	\$3,280	\$11,547	\$318	\$68,722	\$25,648	\$8,902	\$3,811	\$11,456	\$74
Gains Taxed as Ordinary Income	\$80,799	\$43,421	\$6,474	\$15,219	\$754	\$37,774	\$22,459	\$2,622	\$16,564	\$2,488	\$9
Other Income	(\$701)	(\$17)	\$710	\$181	\$66	\$62	(\$1,508)	\$558	\$61	\$256	\$0
<b>Total</b>	<b>\$162,705</b>	<b>\$557,490</b>	<b>\$113,595</b>	<b>\$505,087</b>	<b>\$25,012</b>	<b>\$416,615</b>	<b>\$552,010</b>	<b>\$192,155</b>	<b>\$141,444</b>	<b>\$99,287</b>	<b>\$5,378</b>
<b>Montana Additions to Federal Income</b>											
Interest on Non-MT Municipal Bonds	\$244	\$276	\$184	\$63	\$5	\$837	\$1,501	\$13	\$26	\$41	\$0
State and Local Income Taxes	\$107	\$416	\$534	\$458	\$146	\$213	\$903	\$93	\$837	\$34	\$20
Other	\$699	\$461	\$39	\$491	\$5	\$618	\$753	\$109	\$21	\$0	\$0
<b>Total</b>	<b>\$1,050</b>	<b>\$1,152</b>	<b>\$757</b>	<b>\$1,012</b>	<b>\$156</b>	<b>\$1,668</b>	<b>\$3,157</b>	<b>\$214</b>	<b>\$884</b>	<b>\$75</b>	<b>\$20</b>
<b>Montana Subtractions to Federal Income</b>											
Interest on Federal Bonds	\$52	\$63	\$171	\$15	\$3	\$165	\$8,487	\$0	\$6	\$4	\$0
Purchases of Recycled Materials	\$3	\$72	\$227	\$97	\$0	\$0	\$0	\$0	\$25	\$0	\$0
Other	\$1,565	\$439	\$73	\$1,023	\$83	\$2,698	\$24,367	\$1,656	\$2,527	\$32	\$4
<b>Total</b>	<b>\$1,620</b>	<b>\$573</b>	<b>\$471</b>	<b>\$1,135</b>	<b>\$85</b>	<b>\$2,863</b>	<b>\$32,854</b>	<b>\$1,657</b>	<b>\$2,558</b>	<b>\$35</b>	<b>\$4</b>
<b>Deductions</b>											
Section 179 Expense Deduction	\$20,631	\$32,097	\$4,920	\$23,539	\$698	\$6,986	\$11,923	\$6,539	\$7,319	\$4,431	\$141
Other Expense Deductions	\$131,845	\$15,403	\$2,271	\$9,919	\$1,245	\$9,269	\$17,787	\$3,200	\$2,924	\$1,374	\$14
<b>Total</b>	<b>\$152,476</b>	<b>\$47,500</b>	<b>\$7,191</b>	<b>\$33,458</b>	<b>\$1,944</b>	<b>\$16,255</b>	<b>\$29,710</b>	<b>\$9,738</b>	<b>\$10,243</b>	<b>\$5,805</b>	<b>\$155</b>
<b>Total Net Montana Source Income</b>	<b>\$9,659</b>	<b>\$510,569</b>	<b>\$106,689</b>	<b>\$471,506</b>	<b>\$23,138</b>	<b>\$399,164</b>	<b>\$492,604</b>	<b>\$180,974</b>	<b>\$129,528</b>	<b>\$93,522</b>	<b>\$5,240</b>

Contact the department at (406) 444-6900 for a large-print copy of this table.

As the table on the next page shows, the amount of pass-through income also varies significantly for Montana's pass-through partnerships. In 2018, Financial Activity partnerships generated a little more than \$558.3 million in income within Montana, which is more than double the income generated by any other partnership sector. Unlike S Corporations, two partnership pass-through sectors reported negative pass-through income for their owners. In 2018, the Natural Resources and Unclassified sectors reported nearly \$74 million in combined losses during the year.

## Montana-Source Income Passed Through to Owners - Partnerships - 2018 (Thousands of Dollars)

	Natural Res. and Mining	Construction	Manufacturing	Trade, Trans. and Utilities	Info.	Financial Activities	Pro. and Business Services	Ed. and Health Serv.	Leisure and Hospitality	Other Ser- vices	Unknown/ Public Admin.
<b>Returns</b>	4,031	1,355	566	1,984	301	16,888	2,268	481	1,504	673	194
<b>Income Items</b>											
Salaries and Other Fixed Payments to Owners	\$17,252	\$13,151	\$7,359	\$15,239	\$2,459	\$21,890	\$28,252	\$39,754	\$9,235	\$4,367	\$288
Ordinary Business Income	\$18,829	\$47,609	\$11,782	\$91,111	\$170,275	\$147,070	\$126,384	\$132,218	\$14,833	\$10,787	(\$2,611)
Rental Income											
Real Estate	\$11,465	\$105	\$526	\$1,435	(\$145)	\$127,623	(\$10,167)	\$1,708	\$2,133	\$952	\$260
Other	\$684	\$42	\$311	(\$1,809)	\$3,615	(\$10,760)	(\$32)	\$61	\$400	\$4	\$1,955
Interest	\$10,509	\$677	\$1,710	\$5,846	\$6,432	\$40,744	\$3,734	\$3,145	\$625	\$323	\$49
Dividends	\$1,578	\$81	\$714	\$312	\$32	\$20,415	\$8,094	\$99	\$81	\$355	\$46
Royalties	\$96,371	\$398	\$1,139	\$126	\$294	\$17,981	\$1,234	\$787	\$142	\$1,023	\$235
Capital Gains	\$21,432	\$5,775	\$700	\$849	\$51	\$68,209	\$26,001	\$421	\$5,056	\$340	\$43
Gains Taxed as Ordinary Income	\$92,918	\$1,209	\$3,261	\$3,426	\$126,812	\$149,902	\$90,541	(\$3,381)	\$6,874	\$1,992	\$443
Other Income	(\$2,907)	\$671	\$6,939	\$2,150	\$125	\$17,566	\$30,568	(\$187)	\$85	\$1,684	\$26
<b>Total</b>	<b>\$268,130</b>	<b>\$69,718</b>	<b>\$34,441</b>	<b>\$118,685</b>	<b>\$309,950</b>	<b>\$600,640</b>	<b>\$304,609</b>	<b>\$174,627</b>	<b>\$39,466</b>	<b>\$21,826</b>	<b>\$735</b>
<b>Montana Additions to Federal Income</b>											
Interest on Non-Montana Municipal Bonds	\$816	\$39	\$0	\$0	\$0	\$2,507	\$23	\$933	\$1	\$177	\$2
State and Local Income Taxes	\$92	\$43	\$28	\$172	\$325	\$528	\$885	\$42	\$108	\$3	\$2
Other	\$8	\$17	\$4	\$1,564	\$5	\$56,578	\$842	\$74	\$425	\$0	\$4
<b>Total</b>	<b>\$916</b>	<b>\$99</b>	<b>\$31</b>	<b>\$1,736</b>	<b>\$329</b>	<b>\$59,614</b>	<b>\$1,750</b>	<b>\$1,048</b>	<b>\$534</b>	<b>\$179</b>	<b>\$7</b>
<b>Montana Subtractions to Federal Income</b>											
Interest on Federal Bonds	\$41	\$4	\$2	\$1	\$1	\$1,206	\$11	\$0	\$0	\$12	\$0
Purchases of Recycled Materials	\$0	\$0	\$0	\$3	\$0	\$0	\$0	\$0	\$7	\$0	\$0
Other	\$3,890	\$41	\$271	(\$1,996)	\$8	\$12,766	\$23,974	\$251	\$1,525	\$6	\$0
<b>Total</b>	<b>\$3,931</b>	<b>\$46</b>	<b>\$273</b>	<b>(\$1,992)</b>	<b>\$9</b>	<b>\$13,972</b>	<b>\$23,985</b>	<b>\$251</b>	<b>\$1,533</b>	<b>\$18</b>	<b>\$0</b>
<b>Deductions</b>											
IRS Section 179 Expense Deduction	\$12,908	\$3,139	\$1,484	\$3,513	\$412	\$2,920	\$1,673	\$470	\$3,323	\$1,266	\$57
Other Expense Deductions	\$325,892	\$2,815	\$7,527	\$28,250	\$15,046	\$85,078	\$43,179	\$8,619	\$4,013	\$1,211	\$857
<b>Total</b>	<b>\$338,800</b>	<b>\$5,953</b>	<b>\$9,011</b>	<b>\$31,763</b>	<b>\$15,458</b>	<b>\$87,999</b>	<b>\$44,852</b>	<b>\$9,089</b>	<b>\$7,335</b>	<b>\$2,477</b>	<b>\$914</b>
<b>Total Net Montana Source Income</b>	<b>(\$73,685)</b>	<b>\$63,818</b>	<b>\$25,189</b>	<b>\$90,650</b>	<b>\$294,813</b>	<b>\$558,283</b>	<b>\$237,522</b>	<b>\$166,335</b>	<b>\$31,132</b>	<b>\$19,510</b>	<b>(\$171)</b>

Contact the department at (406) 444-6900 for a large-print copy of this table.

## Pass-through Entities by Size - Number of Owners - 2018

Pass-through entities vary greatly in size. Approximately 52 percent of Montana's S Corporation pass-throughs reported a single owner and 69 percent of partnership pass-through entities with Montana source income had two or three owners. Overall, pass-throughs that operate in multiple states tend to have more owners than pass-throughs that only operate in Montana. Among S Corporations, fewer than 6 percent of pass-throughs that only operated in Montana in 2018 had more than eight reported owners, while more than 6 percent of multi-state S Corporations had at least nine owners. At the same time, 26.6 percent of Montana's multi-state partnership pass-throughs had more than eight owners, which is nearly 10 times larger than the proportion of Montana-only partnerships with at least nine reported owners.

Number of Reported Owners	S Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
	Number	%	Number	%	Number	%	Number	%
1	13,807	55.0%	3,668	42.1%	44	0.2%	54	0.5%
2 to 3	9,912	39.5%	3,197	36.7%	16,133	79.7%	5,023	48.0%
4 to 8	1,235	4.9%	1,217	14.0%	3,503	17.3%	2,607	24.9%
9 to 20	139	0.6%	411	4.7%	459	2.3%	1,044	10.0%
Over 20	18	0.1%	220	2.5%	103	0.5%	1,738	16.6%
Total	25,111		8,713		20,242		10,466	

## Pass-through Entities by Size - Montana Source Income - 2018

The following table shows the number and percentages of pass-through entities in six groups based on the entity's Montana source income. As the following table shows, many S Corporations and approximately 48 percent of all partnerships reported zero, or negative, Montana source income on their returns. And while S Corporations and partnerships tend to be used as business structures for smaller businesses, there are some partnerships and S Corporations that have substantial Montana source income of more than \$5 million. Thirty-nine S Corporations and 74 partnerships reported more than \$5 million in Montana source income.

Montana - Source Income	S Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
	Number	%	Number	%	Number	%	Number	%
\$0 or Negative	6,928	27.5%	4,254	48.2%	8,546	42.1%	6,267	59.3%
\$1 to \$10,000	3,527	14.0%	2,557	28.9%	3,381	16.7%	2,365	22.4%
\$10,001 to \$100,000	10,318	41.0%	1,347	15.2%	5,963	29.4%	1,234	11.7%
\$100,001 to \$1,000,000	4,165	16.5%	584	6.6%	2,176	10.7%	577	5.5%
\$1,000,001 to \$5,000,000	214	0.9%	74	0.8%	183	0.9%	89	0.8%
Over \$5,000,000	22	0.1%	17	0.2%	31	0.2%	43	0.4%
Total	25,174		8,833		20,280		10,575	

The next table shows Montana source income reported by pass-through entities for the same groups provided in the previous table. Most of the income generated by pass-through entities was from entities with over \$5 million in Montana source income. For S Corporation pass-throughs, entities with over \$5 million in Montana source income generated approximately \$606 million in 2018, which is 25 percent of all the Montana source income generated by Montana's S Corporation pass-throughs. Partnership pass-throughs with over \$5 million in Montana source income generated \$1.4 billion in Montana source income in 2018.

Montana - Source Income	S Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
	\$ million	%	\$ million	%	\$ million	%	\$ million	%
\$0 or Negative	(\$330)	(18.2%)	(\$90)	(14.9%)	(\$855)	(94.6%)	(\$565)	(84.6%)
\$1 to \$10,000	\$16	0.9%	\$6	1.0%	\$14	1.5%	\$5	0.8%
\$10,001 to \$100,000	\$430	23.7%	\$48	7.9%	\$231	25.5%	\$45	6.7%
\$100,001 to \$1,000,000	\$1,019	56.2%	\$175	29.0%	\$580	64.1%	\$177	26.6%
\$1,000,001 to \$5,000,000	\$389	21.4%	\$145	24.1%	\$325	35.9%	\$182	27.2%
Over \$5,000,000	\$289	15.9%	\$318	52.8%	\$610	67.5%	\$824	123.3%
Total	\$1,813		\$602		\$905		\$668	



# Estates and Trusts

## Taxation of Estates and Trusts

Estates and trusts are legal arrangements where one party holds assets on behalf of or for the benefit of one or more other parties. The details of these legal arrangements vary widely due to the purpose of the estate or trust, and because of the variations in the laws of the states in which they were created.

A trust generally is managed by one or more trustees. The estate of a decedent is managed by an executor. The manager of a bankruptcy estate is called a trustee or a debtor in possession, depending on whether the estate is created under Chapter 7 or Chapter 11 of the federal bankruptcy code. Managers of trusts and estates are referred to as fiduciaries because of their fiduciary duty to act in the interest of another party rather than in their own interest.

When an estate or trust earns income it may distribute part or all of the income to one or more beneficiaries or it may keep part or all of the income. Beneficiaries are taxed on income distributed to them and the estate or trust is taxed on income it keeps.

A trust may also distribute part of the principal to one or more beneficiaries. All estates and many trusts are created with the intention of ultimately distributing all their assets. Distributions from the principal of an estate or trust are not taxable.

Montana taxes the income of a trust or estate as if the trust or estate were an individual, with the exception that a trust or estate is allowed a deduction for income distributed to beneficiaries. Some trusts are created to provide funds for charity and estates and trusts are allowed a deduction for charitable contributions.

Estates and trusts may file on a tax year that is different from the calendar year. In this section, information is reported based on the calendar year when the estate or trust's tax year started. Tax years numbered 2018 may have ended any time between December 31, 2018, and December 30, 2019. Returns are due by the 15th day of the fourth month after the end of the tax year, but taxpayers may receive a six-month filing extension. Thus, 2018 is the latest tax year for which all returns had been filed and processed by the time of publication of this report.

## Types of Estates and Trusts

The Montana return asks the fiduciary to indicate that the return is for one of 11 types of estate or trust. The following table shows the number of returns in each category for 2017 and 2018.

	2017	2018
Simple Trust	2,451	2,409
Complex Trust	4,754	4,755
Decedent's Estate	1,653	1,525
Grantor Trust	6,703	6,462
Electing Small Business Trust	10	13
Qualified Disability Trust	84	104
Bankruptcy Estate (Chapter 7)	13	11
Bankruptcy Estate (Chapter 11)	*	*
Qualified Funeral Trust	*	*
Pooled Income Fund	*	*
Other	396	381
<b>Total</b>	<b>16,069</b>	<b>15,670</b>

*\*Not disclosed due to confidentiality concerns*

A *simple trust* is a trust where all income is to be distributed to the beneficiaries, no income is to be used for charitable purposes, none of the principal is to be distributed, and capital gains are to be allocated to the principal. A complex trust is a trust that does not qualify as a simple trust and does not fall into one of the other categories. A decedent's estate is charged with distributing assets in accordance with the decedent's will or state law and preserving assets until they are distributed.

A *grantor trust* is a trust where the person who created the trust retains control of or an ownership interest in the trust's assets. For both federal and Montana taxes, a grantor trust is treated as a disregarded entity: Its income is treated as belonging to the grantor and its income and deduction line items should be reported on the grantor's tax return.

An *electing small business trust* is a trust that holds shares in an S Corporation and for which the trustee has made an election to be taxed under a different section of federal law than generally applies to trusts. Montana taxes electing small business trust the same as other trusts.

A *qualified disability trust* is a trust whose beneficiaries are one or more disabled persons under the age of 65. A bankruptcy estate holds the assets of a bankrupt individual or business and is charged either with liquidating those assets to repay debts (Chapter 7) or with reorganizing the business (Chapter 11).

A *qualified funeral trust* is a type of grantor trust set up to pay the beneficiary's funeral expenses. A pooled income fund is an arrangement where individuals or businesses donate assets to a charity with the provision that the donor is to receive part or all of the earnings from the assets for a fixed period or for life.

## Income of Estates and Trusts

Montana law considers a trust to be a resident trust if the trust has sufficient connection to Montana. This includes having its primary place of administration in Montana, property located in Montana, and beneficiaries located in Montana. A trust is classified as a part-year resident trust if sufficient connection with the state has ceased during a year. A trust or estate that is created during a year has a short tax year but is considered either resident or non-resident.

All of a resident trust's income is taxable by Montana, but a trust with income that has its source in another state may claim a credit against Montana tax for tax paid to another state. Montana source income of a nonresident trust is taxable by Montana. As with a non-resident individual, a non-resident trust calculates tax on all its income and then multiplies this calculated tax by the share of its income that has a Montana source.

The following table shows the different types of income reported by trusts and estates. It shows income of resident estates and trusts and non-resident and part-year resident estates and trusts separately. For nonresident and part-year resident estates and trusts, it shows the average nonresident / part-year resident ratio used in calculating their tax. This is the ratio of total Montana source income to total income from all sources.

### Income Reported on Estate and Trust Returns (\$ million)

Type of Income	2017		2018	
	Resident	Nonresident and Part-Year	Resident	Nonresident and Part-Year
Interest	\$14.175	\$203.728	\$14.503	\$230.510
Dividends	\$52.110	\$546.011	\$56.563	\$364.314
Sole Proprietor Business Income	(\$4.261)	(\$7.143)	(\$1.364)	\$15.823
Pass-Through Business, Rents, Royalties	\$51.628	\$898.391	\$54.309	\$978.319
Gain or Loss on Asset Sales				
Taxed as Capital Gains	\$81.786	\$1,543.413	\$109.090	\$1,745.741
Taxed as Ordinary Income	(\$1.053)	\$44.372	(\$2.896)	\$20.309
Other	\$21.051	\$116.087	\$18.391	\$138.981
<b>Total</b>	<b>\$215.435</b>	<b>\$3,344.859</b>	<b>\$248.596</b>	<b>\$3,493.997</b>
Average Resident Ratio for Nonresident and Part-Year Resident Estates and Trusts		0.74%		0.87%

## Deductions for Charitable Contributions and Distributions to Beneficiaries

Income earned by a trust or estate generally is put to one of four uses. It may be used to pay costs of the trust, it may be donated to charity, it may be distributed to a beneficiary, or it may be retained and added to the principal of the trust. In calculating taxable income, an estate or trust is allowed an itemized deduction for charitable contributions in the same way an individual is. Unlike an individual, an estate or trust is allowed a deduction for income distributed to a beneficiary. An estate or trust may also distribute part of the principal, but this is not deductible for the trust or taxable for the beneficiary. The following table shows deductions for charitable contributions and for distributions to beneficiaries.

	2017		2018	
	Entities with Deduction	\$ million	Entities with Deduction	\$ million
<b>Charitable Contributions</b>				
Resident Estates and Trusts	240	\$7.650	206	\$18.210
Nonresident and Part-Year	528	\$115.305	511	\$773.567
<b>Distributions from Income</b>				
Resident Estates and Trusts	3,316	\$117.354	3,258	\$136.639
Nonresident and Part-Year	1,016	\$966.874	1,058	\$951.592

## Tax Paid by Estates and Trusts

Trusts and estates directly pay about \$4 million in tax per year. The following table shows tax paid by type of trust or estate. Categories with few returns are combined to protect taxpayer confidentiality.

### Tax After Capital Gains Credit and Apportionment (\$ million)

Entity Type	2017	2018
Bankruptcy Estates	\$0.000	\$0.000
Decedent Estates		
Resident	\$0.619	\$0.516
Nonresident and Part-Year	\$0.008	\$0.155
Electing Small Business Trusts		
Resident	\$0.000	\$0.000
Nonresident and Part-Year	\$0.001	\$0.000
Grantor Trusts	\$0.000	\$0.000
Simple Trusts		
Resident	\$0.556	\$0.670
Nonresident and Part-Year	\$0.062	\$0.058
Disability, Funeral, Pooled Income, and Other	\$0.010	\$0.014
Complex Trust Not in Another Category		
Resident	\$1.468	\$1.856
Nonresident and Part-Year	\$0.554	\$0.565
All Estates and Trusts	\$3.278	\$3.835

# Corporate Income Tax

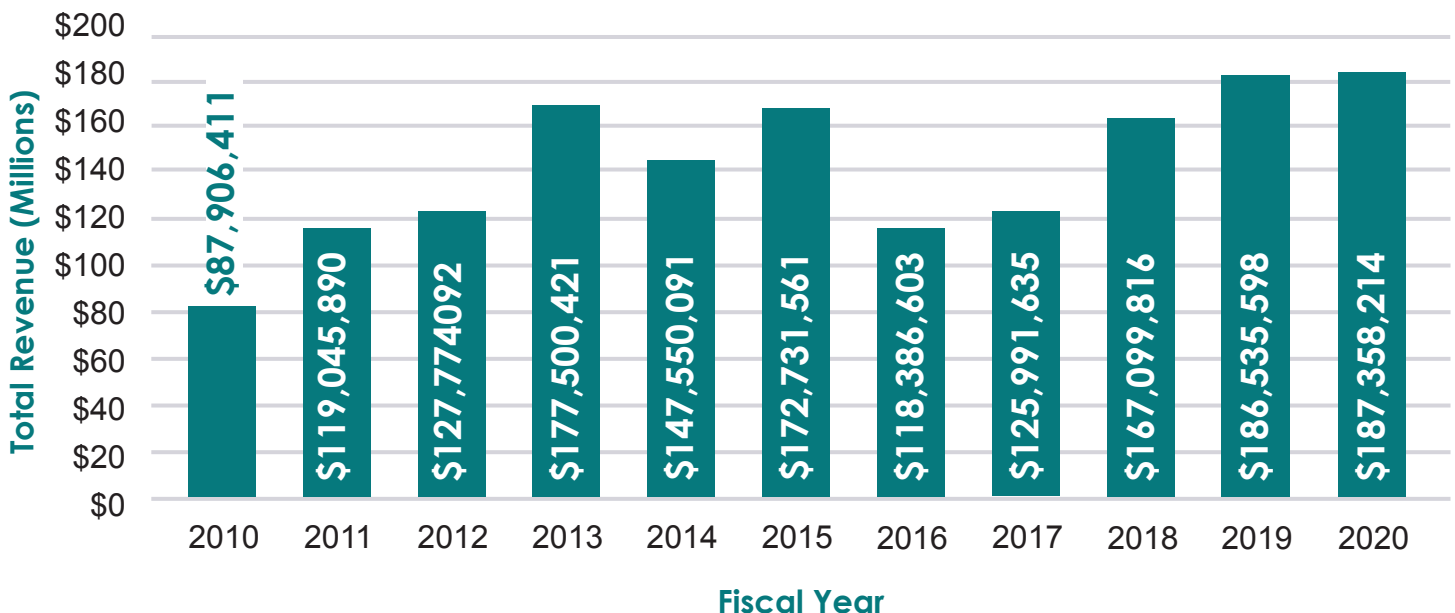
Montana's corporate income tax is a tax levied on C Corporations for the "privilege of carrying on business in this state for the tax year in which the income was earned." (15-31-101(3), MCA). A corporation includes:

An association, joint-stock company, common-law trust or business trust that does business in an organized capacity; all other corporations whether created, organized, or existing under and pursuant to the laws, agreements, or declarations of trust of any state, country or the United States; and any limited liability company, limited liability partnership, partnership or other entity that is treated as an association for federal income tax purposes and that is not a disregarded entity (15-31-101(1), MCA).

Every bank organized under the laws of the state of Montana, of any other state, or of the United States, and any savings and loan association organized under the laws of this state or of the United States is subject to the Montana corporate income tax (15-31-101(4), MCA).

The table below shows total corporate income tax collections for Fiscal Years 2010 through 2020. As a rule, corporate income tax collections in Montana follow the general national economy. Fiscal Year 2019 and 2020 corporate tax revenues were \$186.5 million and \$187.4 million, respectively. Corporate income taxes are deposited in the state general fund.

## Corporate Income Tax



The following table provides a breakdown for the last seven years of revenues deposited in the general fund by how they are collected and also shows refunds.

As the table shows, estimated quarterly payments are by far the largest source of corporate income tax collections followed by payments with returns.

## Corporate Income Tax Collections and Refunds - General Fund

Fiscal Year	Payments with Returns	Estimated Payments	Audits, Penalties, and Interest	Refunds	Total Collections
FY 2014	\$28,136,519	\$130,352,294	\$10,765,481	(\$21,706,704)	\$147,547,591
FY 2015	\$31,109,657	\$129,923,853	\$28,775,440	(\$17,972,938)	\$171,836,012
FY 2016	\$29,079,903	\$108,541,034	\$13,308,491	(\$31,390,463)	\$119,538,965
FY 2017	\$31,668,677	\$107,111,190	\$12,318,708	(\$25,851,754)	\$125,246,820
FY 2018	\$42,743,886	\$129,097,865	\$26,779,392	(\$24,228,007)	\$174,393,137
FY 2019	\$50,422,525	\$137,292,282	\$15,050,080	(\$16,752,844)	\$186,012,044
FY 2020	\$50,251,684	\$145,585,206	\$10,871,377	(\$20,028,455)	\$186,679,812
Average	\$37,630,407	\$126,843,389	\$16,838,424	(\$22,561,595)	\$158,750,626

Average estimated payments over the past seven years were \$126.8 million. Average annual revenue for payments with returns over the same period was \$37.6 million. The seven-year average of revenue from audits, penalties, and interest was \$16.8 million. Total refunds averaged about \$22.6 million per year.

Over the past seven years, total corporate tax collections averaged about \$158.8 million annually. However, there was wide variation in annual collections over that time period.

## Who pays Corporate Income Taxes?

Only C Corporations pay corporate income taxes. Corporations that elect to file as a subchapter S Corporation for federal tax purposes are also required to file as a Subchapter S Corporation for Montana income tax purposes. Despite the filing requirement, Subchapter S Corporations do not pay Montana corporate income taxes. Instead, the owners or shareholders of the S Corporation are subject to income tax on income flowed through the S Corporation to the owner or shareholder. Then the owner or shareholder reports any taxable income on their individual income tax form. S Corporations are discussed more in the section on pass-through entities.

Organizations exempt from the tax include corporations or associations organized and operated exclusively for religious, charitable, scientific, or educational purposes, and whose income does not benefit any stockholder or individual.

Under federal law, unrelated business taxable income of exempt organizations that create more than \$100 of federal tax liability is taxable as corporate income in the same manner as other taxable corporate income.

Other entities exempt from corporate income tax include labor, agricultural or horticultural organizations; civic organizations operated exclusively for the promotion of social welfare; clubs or corporations organized and operated exclusively for pleasure, recreation or other nonprofit purposes and who do not have any income that benefits any private stockholder or member; and similar nonprofit organizations.

To be exempt from state corporation taxes, the corporation must prove it is in compliance with all statutory conditions. Research and development (R&D) firms organized to engage in business for the first time in Montana do not have to pay the corporate income tax for the first five years of operation. To receive this exemption, the firm must apply to the Department of Revenue for approval.

### Returns Filed for Tax Year 2017

Total C Corporations	16,396
S Corporations	63,102
Total Corporations	79,498
C Corporations Paying Minimum Tax*	10,559
C Corporations Paying More Than Minimum Tax	5,837

### Returns Filed for Tax Year 2018

Total C Corporations	16,587
S Corporations	64,870
Total Corporations	81,457
C Corporations Paying Minimum Tax*	10,510
C Corporations Paying More Than Minimum Tax	6,077

*\*Includes corporations filing a tax return, but claiming zero or negative taxable income.*

## Distribution of Corporate Income Taxes

The following table shows the distribution by Montana tax liability of the 16,587 corporate returns with a Montana tax liability filed in calendar years 2019 and 2020 reporting on Tax Year 2018. Note that the revenues from the return data will not match the fiscal year revenues in earlier tables because fiscal year revenue is based upon payments.

### Tax Year 2018 Distribution of Montana Tax Liability

C Corporation Returns	Number	Tax Liability	Percent of Total Liability	Cumulative Percent of Total Liability
Top 100 returns	100	\$112,389,276	67%	67%
Second 100 returns	100	\$16,212,149	10%	76%
Third 100 returns	100	\$8,798,636	5%	81%
Fourth 100 returns	100	\$5,929,060	4%	85%
Fifth 100 returns	100	\$4,337,417	3%	88%
All other returns	16,087	\$21,039,128	12%	100%
Total	16,587	\$168,705,666	100%	N/A

*Includes refunds as negative revenue.*



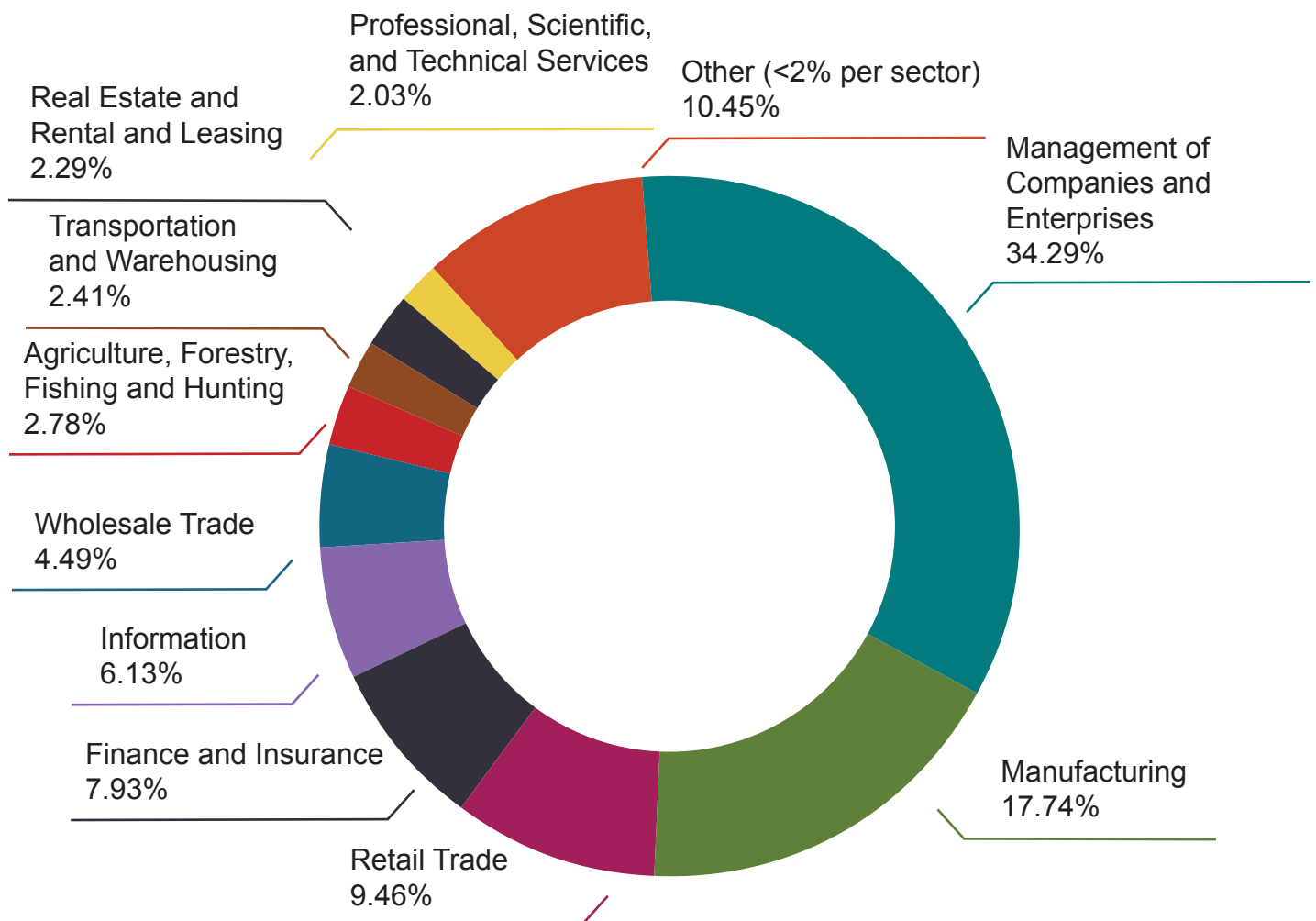
Altogether the top 100 returns constituted about 67 percent of total tax liability for the entire group of taxpayers. The top 500 returns accounted for 88 percent of total Montana tax liability for the group. The other 16,087 returns accounted for only 12 percent of the total Montana tax liability.

Another way to look at the distribution of corporate income taxes is by economic sector. Starting with the 2009 tax returns, corporate taxpayers were asked to identify their primary industry just as identified on their federal tax forms. The following pie chart shows the distribution of corporate income taxes for the largest sectors.

The largest sector in terms of Tax Year 2018 tax liability was management of companies and enterprises. This includes banks and other holding companies and corporate or regional headquarters and accounted for about 34 percent of all the corporate income tax liability.

Manufacturing was the second largest sector with almost 18 percent of all corporate income taxes in Tax Year 2018. This includes food manufacturing including grain, oilseed, fruit and dairy processing; bakeries; beverages; sawmills, millwork, and paper manufacturing; petroleum and chemical manufacturing; cement and concrete; and other activities.

Corporations primarily involved in retail trade paid 9.5 percent of corporate income taxes; finance and insurance (7.9 percent); information (6.1 percent); and wholesale trade (4.5 percent). All other sectors including mining, quarrying, and oil and gas extraction, transportation and warehousing, and construction made up 20 percent.



When looking at the chart it is important to remember that only businesses organized as C Corporations pay corporate income taxes. Businesses in certain industries, such as agriculture or legal services, may be more likely to be structured as a pass-through entity, rather than as a C Corporation.

## Taxable Income and the Tax Rate

The starting point for calculating Montana corporate income tax is the corporation's federal taxable income. To determine net income taxable by Montana, certain adjustments to federal taxable income must be made. For example, municipal bond interest is taxable and must be added to income. Also, Montana allows certain reductions to income, such as a portion of the cost of energy conservation investments made in a building used for the corporation's business.

After the additions and reductions to federal taxable income required by Montana law, income is then apportioned to Montana to produce Montana taxable income.

If the corporation conducts business that is taxable only in Montana then all of the net taxable income from that business is Montana taxable income. The tax is levied at a rate of 6.75 percent on net income earned in Montana.

Multi-state corporations with net taxable income generated by doing business both inside and outside the state are required to apportion income to Montana based on an equally weighted, three-factor apportionment formula.

### Example of Apportionment Factor Calculation for Multi-State Corporation

Payroll in Montana		Total Payroll		Payroll Factor
\$1,000,000	÷	\$10,000,000	=	0.100
Property In Montana		Total Property		Property Factor
\$2,000,000	÷	\$125,000,000	=	0.016
Receipts In Montana		Total Receipts		Receipts Factor
\$4,000,000	÷	\$100,000,000	=	0.040
Apportionment Factor (Avg.)				0.052

Sales, property, and payroll comprise the three factors used in the apportionment formula. The payroll factor is the ratio of the payroll attributable to the production of business income during the tax period in Montana to all payroll paid. Similarly, the property factor is based on the ratio of Montana property to all property, and the sales factor is based on the ratio of Montana sales to all sales. Once the three factors are calculated they are averaged together to create the overall apportionment factor. That factor is applied against adjusted federal taxable income to produce the net income apportioned to Montana, or Montana taxable income.

The tax is normally levied at a rate of 6.75 percent on net income apportioned to Montana with exceptions explained on the next page.

Following is an example of how a multi-state corporation doing business in Montana would calculate its Montana source income assuming the following facts:

- The corporation has \$1 million in payroll in Montana out of total payroll of \$10 million.
- It has \$2 million of property in Montana out of total property owned by the corporation of \$125 million.
- The corporation has sales in Montana of \$4 million out of total sales for the firm of \$100 million during the tax year.

These facts result in an apportionment factor of 0.052 (see the calculations in the previous table).

If this corporation had total taxable income of \$10 million, its Montana taxable income is \$520,000 ( $\$10 \text{ million} \times 0.052 = \$520,000$ ) and its state income tax is \$35,100 before credits ( $\$520,000 \times 6.75 \text{ percent}$ ).

Relying on an apportionment formula simplifies the calculation of taxable income by state for the multi-state taxpayer and for the state tax administrator, but there can still be issues. A simple example is that of a multi-state taxpayer who over-apportions or shifts one or more of the factors—property, payroll or sales—to a state that does not tax corporate income. Apportioning too much in sales or property or payroll to a non-income tax state reduces other states' apportionment factors and so reduces the income taxable in those states.

Montana is a worldwide, combined unitary state. A business is unitary when the operations of that business within the state depend on or contribute to the operations of that business outside the state. However, in Montana corporations can elect to have primarily their United States income included in the apportionment process. Corporations taking this election, called a "water's edge" election, pay the tax at a rate of 7 percent instead of 6.75 percent. Some limits exist on exclusions claimed under the water's edge election (see 15-31-322 and 15-31-324, MCA).

Multinational unitary corporations wishing to file under the water's edge method are required to file a written election within the first 90 days of the tax period for which the election is to become effective. The Department of Revenue must approve the election before the corporation uses it and the election is binding for three consecutive taxable periods.

Corporations whose only activity in Montana consists of making sales may choose to pay an alternative tax equal to  $\frac{1}{2}$  of 1 percent of gross sales if they do not own or rent real estate or tangible personal property in Montana, and if their annual gross income from sales in Montana does not exceed \$100,000.

There is a minimum tax of \$50 for any corporation doing business in the state. If the corporation has no property, sales, or payroll in the state during the tax period, it is exempt from the minimum tax. In Tax Year 2018, 63 percent of corporations paid the minimum tax or less.

All states with a corporate income tax allow corporations a carry forward of net operating losses (NOL). These losses can be deducted against net taxable income in future years. All states limit the number of years a corporation can carry forward losses. Some states, including Montana, allow carryback of net operating losses.

Beginning in Tax Year 2018, Montana net operating losses of a corporation may be carried back for a period of three years and used to reduce prior years' taxable income and may be carried

forward for up to 10 years to reduce taxable income in those future years. Loss carrybacks may not exceed \$500,000 per tax period. Previously, losses could be carried back three years and forward seven years without any limitation on the carryback amount.

The table on the next page provides a comparison of Montana treatment of net operating loss deductions with that in other states.

In Montana, if a corporation has net operating losses it can file an amended return and claim a refund of previously-paid taxes for any or all the prior three years, with the \$500,000 carryback limitation per tax period beginning in Tax Year 2018.

For example, a hypothetical Montana corporation had net taxable income of \$50,000 each year in years 1, 2, and 3. In year 4 it had losses of \$160,000 and in year 5 it is back to profitability and has taxable income of \$60,000. Based upon these assumptions, the corporation would have paid \$3,375 in corporate income taxes ( $\$50,000 \times 0.0675$ ) in years 1, 2, and 3. In year 4, it had net losses of \$160,000, so it only paid the \$50 minimum corporate income tax. In year 4, the corporation could file amended returns for years 1, 2, and 3. On the amended returns, the taxpayer could claim \$150,000 of year 4 losses against income earned in those prior years, and obtain refunds of taxes paid, or \$10,125 ( $3 \times \$3,375$ ). The remaining \$10,000 of losses would be used as a deduction against year 5 income of \$60,000, reducing taxable income from \$60,000 to \$50,000, and reducing the corporation's tax liability by \$675.

Twenty-nine states do not allow carryback of net operating losses, but do allow carryforward of losses, from five years up to 20 years. Twelve states allow the same carryforward and carryback periods as federal tax law has historically allowed (two years back and 20 years forward). Montana, New York and Utah allow corporations with net operating losses to carry back these losses against the three prior years of income.

A number of states have restricted the amounts of losses that can be carried back and used to obtain refunds or carried forward in any one year. For example, like Montana, Utah provides a three-year carryback of net operating losses, but has a limit of \$1 million on carryback losses.

Idaho allows losses to be carried back against income for up to two years, but limits carryback losses to \$100,000. Idaho allows carryforward of losses for up to 20 years.

North Dakota allows carryforward of losses for up to 20 years, but does not allow carryback of losses.

## States with Corporate Income Taxes Allowed Carryback and Carryforward Periods for Net Operating Loss

### Allowed years of carryforward

		5 years forward	10 years forward	12 years forward	15 years forward	20 years forward
Allowed years of carryback	0 years back	Arkansas Rhode Island	Kansas Michigan New Hampshire Vermont	Illinois	Alabama Minnesota North Carolina Oregon Tennessee	Arizona Colorado Connecticut District of Columbia Florida Indiana Iowa Kentucky Louisiana Maine Massachusetts Nebraska New Jersey New Mexico North Dakota Ohio Pennsylvania South Carolina Wisconsin
	2 years back					Alaska California Delaware Georgia Hawaii Idaho Maryland Mississippi Missouri Oklahoma Virginia West Virginia
	3 years back		Montana		Utah	New York

Source: State Tax Handbook. 2017. CHS; Montana Department of Revenue. 2018.

## Credits

As with individual income tax, corporations with expenditures that qualify under state law can claim tax credits. Tax credits are applied against the corporation's tax liability to reduce the amount the corporation owes.

For example, a corporation with Montana taxable income of \$3,000 has a tax liability of \$202.50 (\$3,000 x 6.75 percent). However, if the corporation has expenditures that qualify under state law for a credit of \$150, its tax liability is reduced to \$52.50 from \$202.50.

## Montana Corporation Tax Credits

Credit	Tax Year 2017		Tax Year 2018	
	No. of Credits	Credit Amounts	No. of Credits	Credit Amounts
Alternative Energy Production Credit	0	\$0	0	\$0
Alternative Fuel Motor Vehicle Conversion Credit	0	\$0	0	\$0
Apprenticeship Tax Credit	0	\$0	*	\$3,068
Biodiesel Blending and Storage Tax Credit	0	\$0	0	\$0
Charitable Endowment Credit	11	\$26,225	13	\$41,806
College Contribution Credit	28	\$6,756	12	\$2,958
Contractor's Gross Receipts Credit	83	\$940,774	75	\$924,808
Dependent Care Assistance Credit	0	\$0	0	\$0
Empowerment Zone New Employees Tax Credit	0	\$0	0	\$0
Geothermal Heating System Credit	0	\$0	*	\$50
Health Insurance for Uninsured Montanans Credit	*	\$68	*	\$50
Historic Property Preservation Credit	*	\$50	*	\$50
Infrastructure Users Fee Credit	*	\$276,976	12	\$579,462
Mineral Exploration Credit	*	\$25	*	\$25
New/Expanded Industry Credit	0	\$0	0	\$0
Oilseed Crushing and Biodiesel Production Facility Credit	0	\$0	0	\$0
Qualified Research Credit	*	\$150	*	\$100
Recycling Credit	*	\$12,982	*	\$38,176
Short-term Temporary Lodging Credit	0	\$0	0	\$0
<b>Total Credits</b>	<b>133</b>	<b>\$1,264,006</b>	<b>126</b>	<b>\$1,590,553</b>

*Some of the above credits are claimed on returns that have not been audited yet. The amount of credit claimed may change once these returns are audited. In addition, some of the above numbers represent a carryback of some credits claimed on amended returns received during the fiscal year. Credits claimed on less than 10 returns are indicated by an asterisk (\*).*

## Filing Requirements and Estimated Payments

Unlike individual income taxpayers who must file their federal and state returns based upon a calendar year, corporate taxpayers must file tax returns based upon their fiscal year. Corporate income taxpayers must use the same tax period for their state return as was used for the federal tax return.

As can be seen in the table in this section, about two-thirds of corporate taxpayers (68 percent) have a fiscal year or tax year that is based upon the calendar year. Tax returns for taxpayers using a calendar year as their fiscal year are due May 15.

The next most used fiscal year or tax year is the 12 months ending at the end of June. About 5 percent of corporate taxpayers filing in Montana used a fiscal year ending at the end of June. Tax returns for taxpayers using another period as their fiscal year are due the 15th day of the fifth month after close of the taxable year. So if a taxpayer's fiscal year ends at the end of June, the tax return is due November 15.

Automatic extensions are allowed for up to six months following the prescribed filing date.

For example, a taxpayer with a fiscal year or tax year that is also a calendar year can use the automatic extension moving the due date of their return from May 15 to November 15. So the Tax Year 2018 return for a taxpayer whose fiscal year is calendar year 2018 would be due May 15, 2019, but the taxpayer would have until November 15 to file under the automatic extension.

A taxpayer whose fiscal year or tax year ends June 30 can obtain an automatic six-month extension that moves the due date for its return from November 15 to May 15 of the following year. So the Tax Year 2018 return for a taxpayer whose fiscal year starts July 1, 2018, and goes through June 30, 2019, is due November 15, 2019. The taxpayer would have until May 15, 2020, to file under automatic extension.

Companies with a tax liability of \$5,000 or more must make quarterly estimated payments. For a corporation operating with a calendar year as its fiscal year or tax year, the due dates for quarterly payments are April 15, June 15, September 15, and December 15. For a corporation using another 12 month period as its fiscal/tax year, the due dates for quarterly installments are the 15th day of the fourth month, the 15th day of the sixth month, the 15th day of the ninth month, and the 15th day of the 12th month.



## Corporate Income Tax - Tax Year 2018

Tax Year Period Ending	Number of Taxpayers	Percent
12/31/2018	11,593	70%
1/31/2019	350	2%
2/28/2019	226	1%
3/31/2019	767	5%
4/30/2019	201	1%
5/31/2019	215	1%
6/30/2019	847	5%
7/31/2019	152	1%
8/31/2019	203	1%
9/30/2019	751	5%
10/31/2019	795	5%
11/30/2019	487	3%
Total	16,587	100%

## Penalties and Interest

Corporations that do not pay taxes when due may be charged a late payment penalty of 1.2 percent per month on the unpaid tax, up to a maximum penalty of 12 percent of the tax due. Beginning July 1, 2019, the interest on unpaid tax accrues at a rate of 3 percentage points above the prime rate. For January 1, 2020, through December 31, 2020, the rate is 8 percent per year.

## Comparison of Corporate Tax Rate with Other States

Forty-four states and the District of Columbia have a tax on corporate income. The comparison table in this section uses data from the Federation of Tax Administrators (as of January 2020) to show the maximum rates for states that have a corporate tax. The rates go from 12 percent down to 2.5 percent. A number of states have a graduated income tax which is indicated by an asterisk next to the state.

This table shows only the maximum rate for each state. The effective or average tax rate in different states can vary substantially, depending upon what the lower rates are and what income they apply to. Furthermore, state tax deductions, exemptions and credits, and other aspects of state taxation policy can substantially reduce the effective tax rate.

Nevada, Ohio, Texas, and Washington do not have corporate income taxes, but do impose gross receipts taxes.

South Dakota and Wyoming do not have corporate income taxes or gross receipts taxes.

South Dakota does have an excise tax on financial institutions which starts at 6 percent on net income of \$400 million or less. The percentage tax declines in steps on net income over that amount.

Wyoming does not have a corporate income tax but does have a corporate franchise tax or license tax of 0.02 percent which applies to the sum of capital, property, and assets located in Wyoming.

Montana's tax rate is 6.75 percent. Idaho's tax rate is 7.4 percent and North Dakota's top corporate income tax rate is 4.31 percent.

## Maximum Corporate Tax Rate by State

Rank	State	Maximum Tax Rate	Rank	State	Maximum Tax Rate
1	Iowa*	12.00%	24	West Virginia	6.50%
2	New Jersey	10.50%	24	Alabama	6.50%
3	Pennsylvania	9.99%	24	Arkansas*	6.50%
4	Minnesota	9.80%	24	Tennessee	6.50%
5	Illinois	9.50%	29	Hawaii*	6.40%
6	Alaska*	9.40%	30	Michigan	6.00%
7	Maine*	8.93%	30	Oklahoma	6.00%
8	California	8.84%	30	Virginia	6.00%
9	Delaware	8.70%	33	New Mexico*	5.90%
10	Vermont*	8.50%	34	Georgia	5.75%
11	District of Columbia	8.25%	35	Indiana	5.50%
11	Maryland	8.25%	36	Kentucky*	5.00%
13	Louisiana*	8.00%	36	Mississippi*	5.00%
13	Massachusetts	8.00%	36	South Carolina	5.00%
15	Wisconsin	7.90%	39	Utah	4.95%
16	Nebraska*	7.81%	40	Arizona	4.90%
17	New Hampshire	7.70%	41	Colorado	4.63%
18	Oregon	7.60%	42	Florida	4.46%
19	Connecticut	7.50%	43	North Dakota*	4.31%
20	Rhode Island	7.00%	44	Missouri	4.00%
20	Kansas	7.00%	45	North Carolina	2.50%
22	Idaho	6.93%			
23	Montana	6.75%			
24	New York	6.50%			

*\*Graduated income tax.*

*As of Jan. 1, 2018, Federation of Tax Administrators*

## Select History of Corporate Income (License) Tax

The corporate license tax was established in 1917. The tax rate was 1 percent and there was no minimum tax.

In 1933, the rate was raised to 2 percent with a minimum tax of \$5. In 1937, the rate was raised to 3 percent. The minimum tax remained \$5. Twenty years later in 1957, the rate was raised to 5 percent and the minimum tax changed to \$10. The tax rate was changed several times in the years between 1960 and 1971 and the minimum tax was increased from \$10 to \$50.

In 1987, the state added the water's edge election, which includes a tax rate of 7 percent for corporations that elect to file as water's edge companies.

In 2013, the name of the corporate license tax was changed to corporate income tax. The change applies to tax years beginning after December 31, 2013.

## Corporate Income Tax - Historic Tax Rates and Minimum Tax

Year	Tax Rate	Minimum Tax	Water's Edge
1987	6.75%	\$50	7%
1971	6.75%	\$50	-
1969	6.25%	\$50	-
1965	5.25%	\$10	-
1960	4.5%	\$10	-
1957	5%	\$10	-
1937	3%	\$5	-
1933	2%	\$5	-
1917	1%	-	-