



Mike Kadas
Director

Montana Department of Revenue



Steve Bullock
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Memorandum

To: Mike Kadas, Director

From: Marla Larson, Tax Policy and Research

Date: August 24, 2016

Subject: Small Business Impact Analysis – MAR 42-2-960. Amendments to Chapters 23 and 26 of Department of Revenue rules concerning Corporate Income Taxes.

The Department of Revenue (DOR) is proposing to amend certain rules affecting corporate income taxpayers. The proposed amendments are to rules ARM 42.23.108, 109, 112, 113, 116, 117, 212, 312, 313, 403, 421, 424, 601, 702, 802, and 805. ARM 42.26.101, 202, 257, 302, 313, and 505 are also proposed to be amended.

As explained in the balance of the memo, my belief after reviewing the proposed amendments is they will either have no impact or will have a positive impact on affected taxpayers. The statute requiring a small business impact statement if there is an impact does not make a distinction between negative or positive impacts so a review is required since there are impacts, even though any impacts appear to be positive. This memo details the reasons for the assessment of either positive or no impacts.

Section 2-4-102(13), MCA defines a small business for the purpose of a small business impact analysis as a business entity, including its affiliates, that is independently owned and operated and that employs fewer than 50 full-time employees. There are more than sixteen thousand corporations that file a corporate income tax return with the state of Montana and many of these would qualify as a small business under the definition above. To the extent possible, those small businesses that are corporations and that may be affected by the proposed changes are described.

Many of the proposed changes to the rule language in Chapters 23 and 26 are to change corporate license tax to corporate income tax. This is because in the 2013 legislative session SB 361 was passed changing the name of the tax in state statute. The proposed name changes in the rules will have no impact on small businesses.

Another set of changes being proposed to these rules is to eliminate language no longer needed because of the passage of time or administrative or legislative changes. For

example, the Department is proposing removing ARM 42.23.117 which explains calculation of a surcharge which was repealed by the 1999 legislature. The change proposed to ARM 42.23.212 is to replace the reference to a particular name for a statute with a reference to the appropriate MCA section, which better complies with the Secretary of State's current format for rules. It should also make it easier for taxpayers to find the referenced statute. The other change proposed to this section is to delete unneeded language. All of these changes will benefit taxpayers, including small businesses, by reducing confusion.

In ARM 42.23.303, 42.23.601, and 42.23.803, there is guidance on what to do concerning certain adjustments or other actions if the time period was before March 13, 1997. The information is no longer needed by all or almost all, taxpayers. In the unlikely event a corporation needs to file a return for a tax period nearly twenty years in the past, it can contact the Department for assistance in complying with filing requirements. Eliminating this outdated guidance should have no impact on small businesses.

A number of the proposed changes are intended to clarify in the rules what has been long-standing practice of the Department.

ARM 42.23.303, as amended, makes it clear what a taxpayer with a change in federal taxable income or in the federal return needs to file regarding their Montana income tax return and the timelines in which the actions need to occur.

ARM 42.23.312, as amended, provides additional, and clearer, guidance on the filing requirements for inactive corporations.

ARM 42.23.313, as amended, provides additional guidance regarding the requirements for obtaining a certificate of dissolution or withdrawal or a certificate of tax clearance from the DOR.

Amendments to ARM 42.23.601 provide improved guidance on refund claims made after the statute of limitations expires.

Amendments to ARM 42.23.804 are intended to make it clear how conversion of a corporate entity to a disregarded entity (sole proprietorship, partnership, or S corporation) will affect net operating losses incurred prior to the conversion.

Amendments to ARM 42.23.805 are intended to clarify how to calculate and apply net operating losses when there is a change in reporting method.

To the extent that corporations are new, or are new to the state, the changes listed above may reduce the uncertainty of certain tax calculations, reduce errors or noncompliance with filing requirements, or reduce the need to consult with the Department. The proposed changes should benefit the businesses affected by them, including small businesses, by reducing problems with returns, missed deadlines for refund claims, or other consequences of not complying with state law.

The amendments to ARM 42.26.202 add definitions for “costs of performance” and “income producing activity” that are effectively the definitions proposed by the Multi-State Tax Commission. These definitions are used in the sales apportionment factor calculation, and therefore affect multi-state corporations, but not corporations doing business only in Montana. To the extent that a small business conducts business in Montana, and also other states that have also adopted these same definitions, this should reduce the effort to comply with state law.

The proposed amendment of ARM 42.26.302 is intended to make it clear that a corporation cannot choose to file as a water’s edge corporation retroactively. State law allows a corporate income taxpayer to make a water’s edge election which is in place for the next three years and which is renewable. Corporations electing to file as water’s edge taxpayers tend not to be small businesses, and instead are almost all larger, multi-national corporations. There may be a very few exceptions to this general rule such as certain Canada-based corporations doing business in Montana, or Montana-based corporations conducting business in Canada, that may meet the definition of a small business. Another proposed amendment to this section eliminates language because it duplicates information already on the form the taxpayer is being directed to use. Another amendment directs the person viewing the rule to other related, and potentially useful, sections of rules. All of these proposed amendments should have positive benefits to taxpayers by reducing errors and time spent on filings.

The proposed amendments of ARM 42.26.311 and ARM 42.26.313 also deal with aspects of the water’s edge election. In the amendment to 311 the goal is to make it clear that all corporations that are part of a group and that are doing business in Montana are included in the water’s edge group. The amendment of 313 clarifies what happens when a non-water’s edge taxpayer is acquired by an entity not previously taxable in Montana and also clarifies what happens in the acquisition of a foreign entity by a Montana taxpayer which has not previously owned foreign entities. As noted above, corporations electing to file as water’s edge taxpayers are mostly larger, multi-national corporations and are not likely to qualify as a small business.

The modification to ARM 42.26.505 removes one of the conditions - shipment or delivery of goods into Montana by various methods – which by itself created a taxable nexus, e.g. when a multi-state corporation’s net business income is taxable by Montana. The revision makes the DOR’s list of activities more consistent with that proposed by the Multi-State Tax Commission, and therefore more likely to be used by other states. To the extent it affects small businesses, it would affect out-of-state small businesses. The impact is expected to be positive, largely because of the increased consistency with other states’ rules, which may reduce filing errors and time spent on filings.