INDIVIDUAL AND CORPORATE INCOME TAX

BIENNIAL REPORT •THE MONTANA DEPARTMENT OF REVENUE

Montana Department of
REVENUE

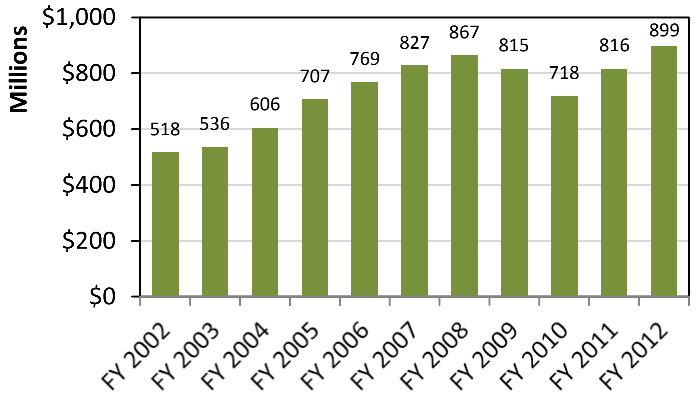
Overview of Individual Income Tax

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 48 percent of general fund revenue for FY 2012. 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 legislature enacted the income tax in 1933, and has made major changes infrequently. The latest changes were made in 2003 (effective for 2005), when the legislature reduced the number of rates, lowered the top rate, capped the itemized deduction for federal taxes, and provided preferential treatment for capital gains income.

Individual Income Tax

Fiscal Year	Total Revenue
FY 2002	$517,567,691
FY 2003	$535,830,664
FY 2004	$605,582,309
FY 2005	$707,343,333
FY 2006	$768,911,933
FY 2007	$827,095,302
FY 2008	$866,638,122
FY 2009	$815,138,193
FY 2010	$717,834,371
FY 2011	$816,089,973
FY 2012	$898,851,201



Federal law provides different rate tables for married couples who file joint and separate returns, and 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 six states that do not have at least one of these provisions. Because of this, most married couples find their tax is lower if they file a joint federal return and separate Montana returns.

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.

Most of the differences between Montana's income tax and the federal tax structure reflect legislative policy decisions, but a few are due to federal limits on state taxation. These state-specific features increase the department's costs of administering the income tax and complicate return preparation for taxpayers who are affected by them.

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, and 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.

Income Tax Returns and Refunds Timely Filed Current Year Returns

Calendar Year	Returns	Returns with Refund	Percent with Refund	Average Refund	Calendar Year	Returns	Returns with Refund	Percent with Refund	Average Refund
2000	529,937	266,152	62%	$376	2006	572,256	311,789	66%	$464
2001	529,955	279,641	65%	$413	2007	591,874	345,972	71%	$506
2002	532,617	287,843	67%	$415	2008	601,078	345,172	70%	$598
2003	536,100	288,154	66%	$405	2009	587,425	337,714	70%	$545
2004	547,623	294,025	66%	$468	2010	596,021	335,904	68%	$532
2005	554,224	297,993	66%	$491	2011	604,758	341,057	68%	$538

The following bills passed by the 2009 Legislative Session affected the individual income tax:

House Bill 21 made permanent the credit for a portion of the cost of investment in property used to collect or process reclaimable material and the extra deduction for 10 percent of a business's costs of buying recycled material. Previously, these tax incentives were set to expire at the end of 2011.

House Bill 163 extended the sunset date for credits for film and television production in Montana from the end of 2009 to the end of 2014.

House Bill 262 made changes to the credit for installing an alternative energy system in the taxpayer's principal residence. It limited the credit to heating systems, and it made masonry heaters and outdoor hydronic heaters that meet certain standards eligible for the credit.

House Bill 315 required that the partial exemption for pension and annuity income be adjusted for inflation each year beginning in 2010.

House Bill 636 exempted part or all of the gain from selling a mobile home park to a tenants' or residents' association, a non-profit that buys the park on behalf of the residents, or a municipal or county housing authority. For a park with 50 or fewer lots, the full gain is excluded from income. For a park with more than 50 lots, half the gain is excluded.

Senate Bill 135 made one change to the Insure Montana credit for small businesses that begin providing group health insurance for employees. Previously, an employer was ineligible if any employee who was not a part-owner was paid wages of more than $75,000 per year. This bill prevents any part-owner of an eligible business who is paid wages of more than $75,000 per year from claiming the credit.

Senate Bill 181 required proceeds from the sale or exchange of real estate to be reported to the Department of Revenue whenever they are required to be reported to the IRS on a Form 1099-S.

Senate Bill 260 allowed publicly traded partnerships to file annual information returns showing partners who received Montana source income in lieu of the normal requirement for a pass-through entity to either pay tax on behalf of its owners or file a form showing that the owners agree to pay tax themselves.

Senate Bill 418 increased the limit on income that a person can earn and still be claimed as another's dependent from $800 to the personal exemption amount. It also allows a taxpayer who the IRS has relieved from liability for their spouse's understatement of tax liability to apply to the department for the same relief.

The following bills passed by the 2011 Legislative Session affected the individual income tax:

House Bill 44 eliminated obsolete statutory language relating to tax credits for certain investments made before 1995.

House Bill 467 clarified that the contributions to the endowment funds of community colleges, tribal colleges, and technical colleges are eligible for the college contribution credit. The department had previously interpreted the law as allowing a credit for these contributions. However, the law did not explicitly list these institutions, and some donors may not have taken the credit because they did not think they were eligible.

Senate Bill 11 corrected an omission in Senate Bill 407, passed by the 2003 Legislature. SB 407 reduced income tax rates, but did not make the corresponding reduction in the withholding rate for lottery winnings. This resulted in lottery winners having income tax over-withheld and then refunded when they filed their returns. Senate Bill 11 reduced the withholding rate for lottery winnings to 6.9 percent, which is the top income tax rate.

Senate Bill 166 created a threshold of $200 of income tax liability before taxpayers who file a tax return and pay tax due by the extension deadline (generally October 15) owe penalty and interest for late filing, late payment, or underpayment through withholding or estimated payments.

Senate Bill 413 made the due date for income tax returns and estimated payments the same as the IRS due date when the IRS due date is affected by a federal or District of Columbia holiday. The IRS deadline in April occasionally is affected by Emancipation Day, which is a holiday in the District of Columbia.

Calculations 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, and
- Recoveries of costs deducted in previous years (primarily refunds of federal taxes previously deducted) are subtracted.

The values of the taxpayer's exemptions and either itemized or standard deductions are subtracted to determine Montana Taxable Income. The value of exemptions and maximum and minimum standard deductions are adjusted for inflation each year:

Personal Income Tax Exemptions and Deductions

		Single and Separate Returns		Joint Returns	
Year	Exemption Amount	Min. Standard Deduction	Max. Standard Deduction	Min. Standard Deduction	Max. Standard Deduction
TY 2008	$2,140	$1,780	$4,010	$3,560	$8,020
TY 2009	$2,110	$1,750	$3,950	$3,500	$7,900
TY2010	$2,130	$1,770	$3,990	$3,540	$7,980
TY 2011	$2,190	$1,820	$4,110	$3,640	$8,220
TY2012	$2,240	$1,860	$4,200	$3,720	$8,400

Tax liability is calculated from the rate table. The rate table is adjusted for inflation each year:

Marginal Tax Rate Structure

Year	TY 2008	TY 2009	TY 2010	TY 2011	TY 2012
1% of the first	$ 2,600	$ 2,600	$ 2,600	$ 2,700	$ 2,700
2% of the next	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 1,400
3% of the next	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 1,400
4% of the next	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 1,400
5% of the next	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 1,400
6% of the next	$ 1,400	$ 1,400	$ 1,400	$ 1,400	$ 1,400
6.9% of remaining	NA	NA	NA	NA	NA

Marginal Tax Rate Income Limits

Year	TY 2008	TY 2009	TY 2010	TY 2011	TY 2012
1.0%	$ 2,600	$ 2,600	$ 2,600	$ 2,700	$ 2,700
2.0%	$ 4,000	$ 4,500	$ 4,600	$ 4,700	$ 4,800
3.0%	$ 7,000	$ 6,900	$ 6,900	$ 7,200	$ 7,300
4.0%	$ 9,500	$ 9,300	$ 9,400	$ 9,700	$ 9,900
5.0%	$ 12,200	$ 12,000	$ 12,100	$ 12,500	$ 12,700
6.0%	$ 15,600	$ 15,400	$ 15,600	$ 16,000	$ 16,400
6.9%	Unlimited	Unlimited	Unlimited	Unlimited	Unlimited

Any credits the taxpayer may claim are subtracted from the tax liability to give the net tax.

- Taxpayers with capital gains income are allowed a credit equal to two percent of their capital gains. In effect, this taxes capital gains at a lower rate than other income.
- Other credits generally are a percentage of a certain type of qualifying expenditure the taxpayer has made.

Income, Deductions, Credits, and Tax Liability

The next six tables show information about individual line items on full year residents' income tax returns for 2010 and 2011. 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.

Montana Individual Income Tax
Income Reported on Full Year Residents Returns
2010 and 2011

	2010		2011	
	Count	**Total**	**Count**	**Total**
Income Items				
Wage and salary income	421,463	13,389,961,904	423,456	13,995,864,062
Taxable interest income	240,816	442,982,605	225,949	376,776,615
Ordinary dividend income	119,123	504,422,291	117,392	465,229,931
Taxable refunds of state/local income taxes	96,094	98,658,563	101,375	93,414,687
Alimony received	841	13,600,236	853	14,061,191
Business income (Schedule C)	77,115	690,830,410	76,742	702,186,969
Capital gains income	100,817	992,631,808	104,234	1,015,745,318
Supplemental gains income	15,454	42,063,648	15,606	41,883,741
IRA distributions - Taxable amt	47,190	548,647,754	49,255	592,390,356
Pension and annuity income - Taxable amt	95,294	1,658,178,065	96,945	1,752,608,148
Rent, royalty, partnership, etc. income	97,166	1,823,262,638	99,493	2,075,865,357
Farm income	19,293	-145,068,389	19,031	-127,273,409
Unemployment compensation	49,163	273,285,163	42,763	192,982,355
Social Security Benefits*	109,426	2,555,665,116	112,747	1,772,577,379
Taxable social security benefits	67,920	603,827,076	71,557	651,771,496
Other income	46,097	-408,809,713	45,029	-511,295,537
Total income	530,507	20,528,474,059	534,102	21,332,211,280
* Indented items either are part of another line or include another line. They are not part of the total.				
Federal Adjustments to Income				
Educator expenses	11,028	3,786,558	11,264	2,648,529
Business expenses	617	1,616,008	651	1,816,393
Health Savings Account deduction	7,345	21,882,122	8,108	24,675,845
Moving expenses	2,791	4,265,332	3,105	4,732,783
One-half self-employment tax	59,722	69,819,591	61,796	76,908,913
Self-employed SEP, SIMPLE, and qual. plans	2,721	43,089,605	2,709	42,298,279
Self-employed health insurance deduction	22,532	110,816,477	22,587	116,579,020
Penalty on early withdrawal of savings	3,845	701,262	3,517	592,044
Alimony paid	1,143	14,315,593	1,162	15,690,176
IRA deduction	14,573	53,329,887	14,530	54,281,327
Student loan interest deduction	45,288	34,202,184	45,162	36,245,983
Tuition & fees deduction	5,601	11,733,181	5,870	12,398,266
Domestic production activities deduction	6,596	43,123,307	6,743	43,533,192
Federal write-ins	316	4,462,208	357	2,343,863
Total adjustments to income	139,614	417,143,315	140,434	434,744,613
Federal Adjusted Gross Income	530,550	20,111,330,744	534,142	20,897,466,667

Montana Individual Income Tax Income Reported on Full Year Residents Returns 2010 and 2011	2010		2011	
	Count	Total	Count	Total
Montana Additions to Federal Adjusted Gross Income				
Interest on other states' municipal bonds	18,034	114,983,672	18,327	102,910,306
Dividends not included in FAGI	429	1,336,567	343	1,016,687
Taxable federal refunds	87,977	126,671,602	81,226	111,495,115
Recoveries of amounts deducted in earlier years	560	1,297,408	207	449,680
Additions to federal taxable social security or railroad retirement	7,724	12,238,467	7,677	11,813,870
Allocation of compensation to spouse	500	7,780,635	511	8,361,792
Medical savings account nonqualified withdrawals	82	101,799	98	121,307
First-time homebuyer's account nonqualified withdrawals	<10	13,722	<10	12,589
Farm and ranch risk management account taxable distributions	<10	191	<10	10,576
Dependent care assistance credit adjustment	64	106,629	39	49,938
Smaller federal estate and trust taxable distributions	85	66,413	83	786,659
Federal net operating loss carryover	4,689	323,147,050	4,617	405,545,941
Federal taxes paid by your S. corporation	67	192,807	44	48,077
Title plant depreciation	11	16,290	<10	793
Group health premiums reimbursed by Insure Montana credit	1,051	6,032,688	813	4,207,414
Other additions	5,228	142,065,523	4,839	155,292,435
Total Montana Additions	114,737	736,051,463	108,232	802,123,179

Montana Individual Income Tax Income Reported on Full Year Residents Returns 2010 and 2011	2010		2011	
	Count	Total	Count	Total
Montana Subtractions from Federal Adjusted Gross Income				
Federal bonds exempt interest	22,473	31,017,274	20,514	25,764,777
Exempt tribal income	7,252	200,800,212	7,175	290,700,359
Exempt unemployment compensation	48,182	268,585,687	42,763	192,982,355
Exempt worker's comp benefits	327	1,990,149	150	786,281
Capital gains from small business investment companies	55	148,811	40	95,032
State tax refunds included in federal AGI	102,810	103,291,864	108,024	97,908,499
Recoveries of amounts deducted in earlier years	145	223,591	23	145,508
Exempt active duty military salary	4,760	153,852,927	4,410	148,526,725
Nonresident exempt military income	117	4,739,141	120	4,212,397
Exempt life insurance premiums reimbursement (National Guard)	56	69,491	46	14,795
Exempt pension income	43,797	142,365,778	44,929	150,693,545
Elderly interest exclusion	70,510	40,226,852	70,622	36,798,111
Exempt retirement disability income (under age 65)	181	786,572	83	364,329
Exempt tip income	13,732	43,592,519	13,883	46,381,919
Exempt income of child taxed to parent	61	113,876	110	252,806
Exempt health insurance premiums taxed to employee	191	677,282	211	843,169
Student loan repayments taxed to health care professional	173	476,765	257	666,300
Medical care savings account exempt deposits	7,812	18,732,448	7,997	19,395,678
First-time homebuyer exempt savings account deposits	140	358,024	155	395,135
Family education savings account exempt deposits	2,760	6,547,256	2,798	6,528,702
Farm and ranch risk management accounts exempt deposits	<10	0	0	0
Subtraction to federal taxable social security/Tier 1 railroad retirement	33,973	125,569,526	35,183	133,165,545
Subtraction for federal taxable Tier II railroad retirement	3,006	37,812,494	3,007	38,836,218
Subtraction for spouse filing joint return: passive loss carryover	69	143,794	43	88,064
Subtraction for spouse filing joint return: capital loss adjustment	2,763	4,409,741	1,647	3,153,880
Allocation of compensation to spouse	504	7,903,312	530	8,523,680
Montana net operation loss carryover	4,362	308,241,632	4,255	390,379,263
40% capital gain exclusion on pre-1987 installment sales	319	1,155,423	49	123,493
Business expense of recycled material	124	204,911	108	266,011
Sales of land to beginning farmers	<10	5,956	<10	55,961
Larger federal estate and trust taxable distributions	95	190,390	151	383,119
Wage deduction reduced by federal targeted jobs credit	146	1,190,418	72	458,655
Certain gains recognized by liquidating corporation	117	794,177	<10	7,069
Other subtractions	4,620	164,001,056	4,773	165,965,197
Total Montana Subtractions	255,249	1,670,219,349	255,523	1,764,862,577

Montana Individual Income Tax
Deductions Reported on Full Year Residents Returns
2010 and 2011

	2010		2011	
	Count	Total	Count	Total
Deductions				
Total medical expenses*	133,552	545,701,986	133,861	545,817,871
Deductible medical expenses	71,855	304,436,666	70,306	301,438,269
Medical insurance premiums not deducted elsewhere	102,983	353,880,862	103,615	364,569,523
Long-term care insurance premiums	13,471	27,300,594	13,475	33,985,594
Federal Income Tax				
Federal income tax withheld*	250,870	9,270,288,809	264,724	9,664,747,196
Federal income tax estimated payments*	47,104	530,290,626	47,233	582,210,945
Last year's federal income tax paid (e.g. with return)*	48,675	231,044,373	54,015	278,790,903
Federal income tax from previous years*	4,742	19,035,603	4,763	22,612,278
Total federal income tax deduction	279,100	1,015,360,042	291,483	1,132,026,533
State or Local Sales Tax*	n/a	n/a	433	446,177
Local income taxes	302	112,039	305	198,088
Real estate taxes	210,973	400,710,387	211,586	411,428,092
Personal property taxes	162,911	52,671,671	167,216	52,698,081
Other deductible taxes	27,639	10,298,211	25,435	9,209,030
Home mortgage interest	159,911	1,075,407,210	159,013	1,008,850,204
Unreported home mortgage interest	6,404	17,246,577	6,341	16,732,698
Unreported points	23,243	6,774,876	22,487	6,128,734
Qualified mortgage ins premiums	19,897	23,239,755	20,847	20,843,664
Investment interest	8,402	37,072,979	8,840	33,364,845
Contributions by cash or check	169,405	443,302,712	169,378	454,876,219
Contributions other than cash or check	71,377	59,815,976	72,985	64,804,361
Carryover of contributions from previous years	3,841	34,781,509	3,662	36,451,707
Child and dependent care expenses	833	1,468,425	851	1,607,286
Casualty and theft losses	499	4,921,842	659	9,738,044
Business Expenses				
Unreimbursed employee business expenses*	56,556	169,613,690	57,209	185,407,740
Other business expenses*	143,319	116,861,859	147,012	126,923,598
Total business expenses*	162,360	286,475,549	166,296	312,331,338
Net deductible unreimbursed business expenses	57,089	198,644,087	58,739	219,574,473
Political contributions	9,052	822,083	7,867	729,898
All other miscellaneous deductions not subject to 2% floor	2,126	7,634,906	2,701	5,625,034
Gambling losses	1,191	10,772,563	1,246	12,302,315
Total itemized deductions	310,090	4,086,694,686	318,088	4,197,628,869
Standard deductions	200,210	708,794,565	197,549	4,911,586,629
Total deductions	525,972	4,795,489,251	530,331	4,911,586,629

* Indented items either are part of another line or include another line. They are not part of the total.

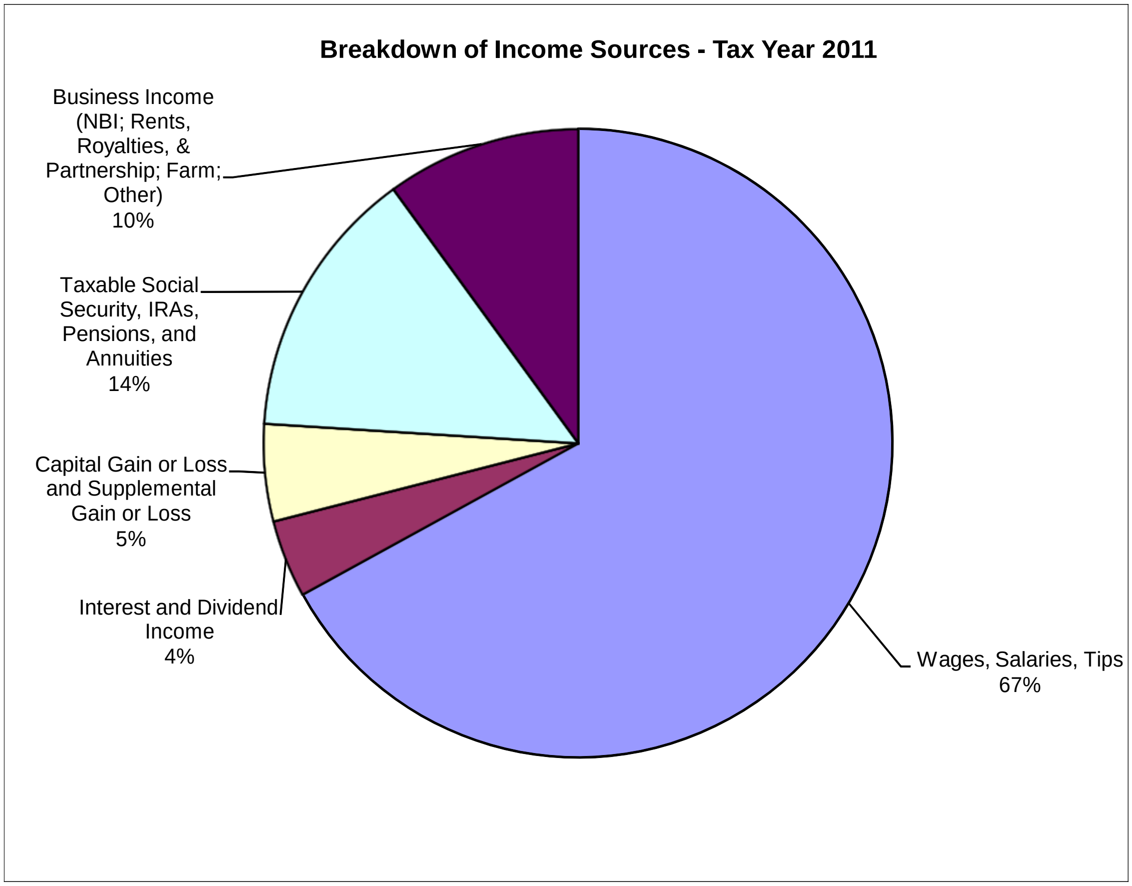
Montana Individual Income Tax
Exemptions, Taxable Income, Tax, and Payments Reported on Full Year Residents Returns
2010 and 2011

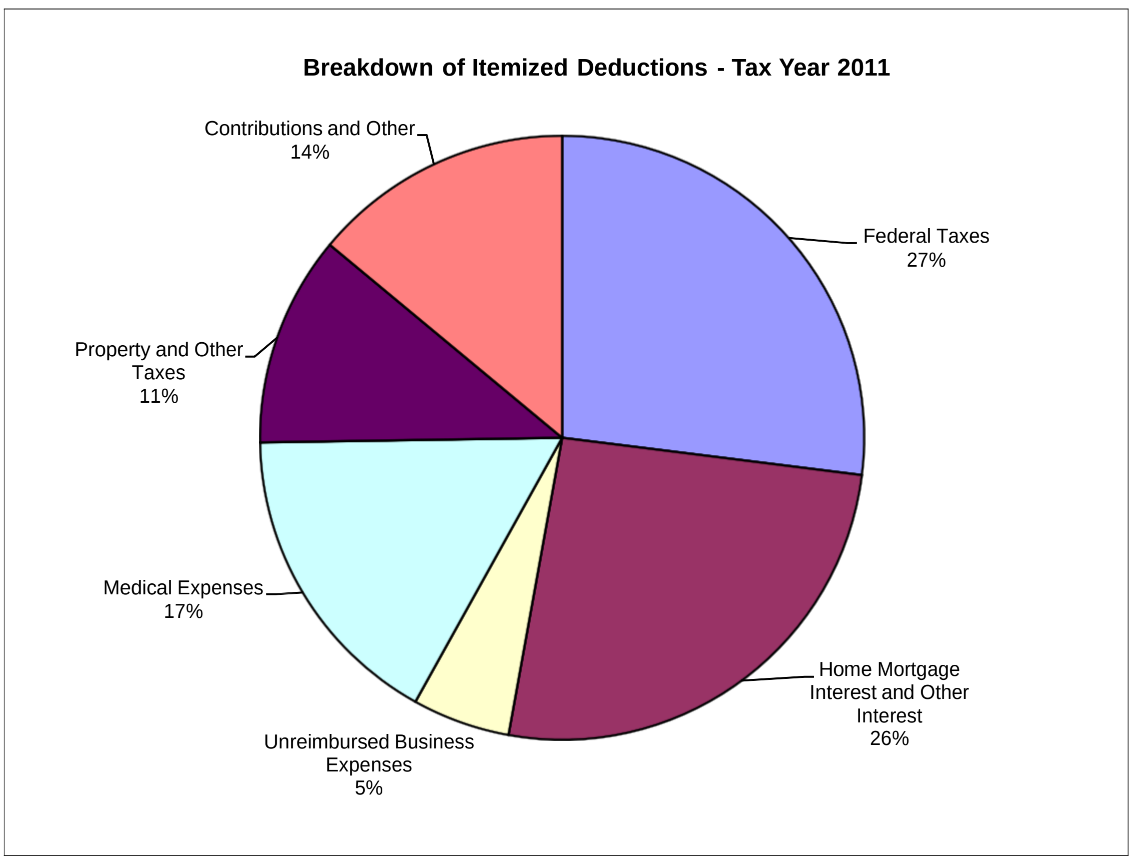
	2010		2011	
	Count	Total	Count	Total
**Exemptions ** **				
Self Exemption		493,735		497,933
Self 65 and Over Exemption		90,519		93,702
Self Blind Exemption		1,256		1,200
TotalTaxpayer Exemptions	493,749	585,510	497,933	592,835
Spouse Exemption		184,292		183,860
Spouse 65 and Over Exemption		32,812		33,820
Spouse Blind Exemption		382		332
Total Spouse Exemptions	85,573	107,100	84,858	106,747
Dependent Exemptions	131,513	234,626	130,760	234,454
Total Exemptions	493,749	927,236	497,933	934,036
Value of Exemptions		2,060,760,090		2,132,354,820
Taxable Income				
Federal Adjusted Gross Income	530,550	20,111,330,744	534,142	20,897,466,667
+Montana Additions	114,737	736,051,463	108,232	802,123,179
-Montana Subtractions	255,249	1,670,219,349	255,523	1,764,862,577
-Deductions	525,972	4,795,489,251	530,331	4,911,586,629
-Value of Exemptions	532,444	2,060,760,090	536,062	2,132,354,820
Montana Taxable Income	435,815	13,665,846,344	441,007	14,315,590,822
Tax from Tax Table	435,092	759,477,805	440,273	796,136,740
Capital Gains Credit	39,364	19,642,186	46,926	19,621,982
Tax before Credits & Adjustments	432,294	739,835,619	436,944	776,514,758
Tax on Lump Sum Distributions	41	10,565	42	6,980
Recapture of Credits Claimed Previously	18	47,148	18	44,518
Total Tax		739,893,332		776,566,256
Payments				
Montana income tax withheld from wages	415,554	616,475,936	419,642	650,148,991
Tax withheld from mineral royalties	2,654	3,072,891	2,753	3,759,669
Tax withheld by pass-through entities	138	136,693	126	255,697
Estimated tax payments	44,664	151,637,977	45,077	160,667,538
Extension payments	4,387	29,393,406	4,671	26,679,620
Total Payments		800,716,903		841,511,515

* 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 themself, 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. Only the total number of taxpayer and spouse exemptions was recorded. For dependent exemptions, the count is the number of returns claiming at least one dependent, and the total is the number of dependents claimed.

Montana Individual Income Tax Credits Reported on Full Year Residents Returns 2010 and 2011				
	2010		2011	
	Count	Total	Count	Total
Credits				
Non-Refundable and No Carryover Credits				
Other states' income tax credit	11,308	20,608,363	11,471	19,090,209
College contribution tax credit	2,900	253,119	2,840	238,141
Qualified endowment tax credit	612	1,737,766	577	1,755,033
Energy conservation tax credit	28,704	10,233,928	16,645	5,588,577
Alternative fuel tax credit	43	25,281	17	26,822
Rural physician's tax credit	14	51,712	0	0
Insurance for uninsured Montanans credit	349	276,066	262	192,670
Elderly care tax credit	53	75,912	52	77,468
Recycling tax credit	109	492,609	94	538,163
Oil seed crushing/biodiesel facility credit	0	0	<10	8,536
Biodiesel blending/storage tank credit	<10	907	<10	46,755
Non-Refundable but With Carryover Credits				
Contractor's gross receipts tax credit	584	3,887,979	636	4,426,212
Geothermal systems tax credit	290	453,992	241	318,928
Alternative energy systems credit	2,476	1,377,478	1,534	823,533
Alternative energy production tax credit	<10	11,360	<10	7,290
Dependent care assistance credit	<10	14,595	10	26,039
Historic property preservation tax credit	22	495,691	24	105,214
Infrastructure user fee credit	13	45,258	12	24,414
Empowerment zone credit	<10	600	<10	475
Research activities tax credit	17	149,977	<10	149,633
Mineral exploration tax credit	12	26,895	0	0
Film production employment tax credit	0	0	0	0
Adoption credit	324	322,517	289	274,849
Total Non-Refundable Credits	45,199	40,542,005	33,106	33,718,961
Refundable Credits				
Elderly homeowner/renter tax credit*	17,127	8,467,974	16,593	8,167,841
Film production employment tax credit	<10	11,480	<10	5,316
Film qualified expenditure tax credit	<10	17,217	<10	20,067
Insure MT small business health insurance credit	952	2,890,619	833	2,156,183
Emergency lodging credit	0	0	<10	863
Total Refundable Credits	18,080	11,387,290	17,429	10,350,270
Total Credits	81,807	73,350,621	65,928	62,934,220

* Credits claimed on tax returns. See the Property Tax section for credits claimed with no income tax return.


Breakdown of Income Sources - Tax Year 2011
Business Income (NBI; Rents, Royalties, & Partnership; Farm; Other) 10%
Taxable Social Security, IRAs, Pensions, and Annuities 14%
Capital Gain or Loss and Supplemental Gain or Loss 5%
Interest and Dividend Income 4%
Wages, Salaries, Tips 67%


Breakdown of Itemized Deductions - Tax Year 2011
Contributions and Other 14%
Federal Taxes 27%
Property and Other Taxes 11%
Medical Expenses 17%
Home Mortgage Interest and Other Interest 26%
Unreimbursed Business Expenses 5%

Income, Deductions, Credits, and Tax Liability

The following tables show Montana adjusted gross income, deductions, taxable income and tax liability by decile group for full year Montana residents only. 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 is counted separately. Figures for non-residents and part-year residents would not be as useful as total income and the income that is apportioned to Montana varies widely for these individuals.

Deciles of Montana Adjusted Gross Income
Full Year Residents
2010 and 2011

	2010				2011			
Decile Group	Returns	Income Range	Montana Adjusted Gross Income		Returns	Income Range	Montana Adjusted Gross Income	
			$ million	% of total			$ million	% of total
1	53,253	less than $3,229	-$632.7	-3%	53,618	less than $3,424	-$722.8	-4%
2	53,254	$3,229 to $8,067	$301.8	2%	53,618	$3,424 to $8,467	$320.2	2%
3	53,254	$8,068 to $13,023	$560.0	3%	53,618	$8,468 to $13,549	$589.0	3%
4	53,253	$13,024 to $18,346	$833.3	4%	53,618	$13,550 to $19,021	$871.3	4%
5	53,254	$18,347 to $24,183	$1,129.5	6%	53,618	$19,022 to $25,025	$1,177.2	6%
6	53,254	$24,184 to $31,280	$1,469.6	8%	53,618	$25,026 to $32,469	$1,532.9	8%
7	53,253	$31,281 to $39,695	$1,882.6	10%	53,618	$32,470 to $41,269	$1,969.2	10%
8	53,254	$39,696 to $50,856	$2,392.7	12%	53,618	$41,270 to $52,896	$2,504.5	13%
9	53,254	$50,857 to $70,800	$3,165.0	17%	53,618	$52,897 to $74,019	$3,321.7	17%
10	53,254	more than $70,800	$8,075.4	42%	53,619	more than $74,019	$8,371.5	42%
All	532,537		$19,177.2		536,181		$19,934.7	

Deductions by Decile Group
Full Year Residents
2010 and 2011

	2010					2011				
Decile Group	% Returns Itemize	Itemized Deductions		Standard Deductions		% Returns Itemize	Itemized Deductions		Standard Deductions	
		$ million	average	$ million	average		$ million	average	$ million	average
1	33%	$152.0	$8,558	$77.8	$2,191	34%	$145.1	$8,047	$79.1	$2,223
2	28%	$92.4	$6,167	$79.0	$2,064	28%	$96.5	$6,414	$81.6	$2,116
3	37%	$133.4	$6,717	$82.1	$2,457	38%	$137.0	$6,666	$84.1	$2,543
4	43%	$174.5	$7,573	$97.6	$3,229	43%	$180.4	$7,761	$101.6	$3,347
5	47%	$208.5	$8,329	$113.4	$4,017	48%	$215.9	$8,326	$114.9	$4,150
6	57%	$269.8	$8,851	$100.8	$4,427	60%	$294.4	$9,149	$98.3	$4,583
7	74%	$415.6	$10,506	$71.3	$5,206	77%	$440.3	$10,629	$67.4	$5,529
8	85%	$566.6	$12,453	$47.7	$6,156	86%	$587.8	$12,680	$46.4	$6,385
9	92%	$740.3	$15,153	$28.2	$6,417	92%	$757.6	$15,369	$28.6	$6,610
10	97%	$1,333.5	$25,894	$11.0	$6,288	97%	$1,342.8	$25,932	$12.0	$6,507
All	59%	$4,086.7	$11,607	$708.8	$3,282	60%	$4,197.6	$11,679	$714.0	$3,362

Deductions as Percent of Montana Adjusted Gross Income
Full Year Residents
2010 and 2011

	2010			2011		
Decile Group	Itemized Deductions	Standard Deductions	All	Itemized Deductions	Standard Deductions	All
1	-30%	-59%	-36%	-25%	-54%	-31%
2	106%	37%	57%	104%	36%	56%
3	63%	23%	38%	60%	23%	38%
4	48%	21%	33%	48%	21%	32%
5	39%	19%	28%	38%	19%	28%
6	32%	16%	25%	32%	16%	26%
7	30%	15%	26%	29%	15%	26%
8	28%	14%	26%	27%	14%	25%
9	25%	11%	24%	25%	11%	24%
10	17%	6%	17%	16%	6%	16%
All	26%	21%	25%	25%	21%	25%

Taxable Income and Tax
Full Year Residents
2010 and 2011

	2010						2011					
Decile Group	Taxable Income			Tax Liability			Taxable Income			Tax Liability		
	$ million	Average	% of Total	$ million	Average	% of Total	$ million	Average	% of Total	$ million	Average	% of Total
1	$0.2	$4	0%	$0.0	$0	0%	$0.2	$4	0%	$0.0	$0	0%
2	$64.0	$1,202	0%	$0.7	$14	0%	$70.0	$1,306	0%	$0.8	$15	0%
3	$220.6	$4,142	2%	$4.0	$76	1%	$234.7	$4,378	2%	$4.3	$81	1%
4	$405.6	$7,617	3%	$10.5	$197	1%	$425.9	$7,944	3%	$11.0	$206	1%
5	$639.5	$12,009	5%	$21.8	$410	3%	$664.7	$12,397	5%	$22.6	$422	3%
6	$917.3	$17,225	7%	$38.6	$725	5%	$953.1	$17,775	7%	$40.0	$747	5%
7	$1,199.2	$22,519	9%	$57.2	$1,074	8%	$1,258.6	$23,474	9%	$60.2	$1,122	8%
8	$1,570.7	$29,494	11%	$82.3	$1,546	11%	$1,656.7	$30,897	12%	$87.2	$1,626	11%
9	$2,173.2	$40,808	16%	$123.7	$2,323	16%	$2,302.8	$42,948	16%	$131.6	$2,455	17%
10	$6,475.5	$121,597	47%	$420.5	$7,896	55%	$6,748.9	$125,867	47%	$438.3	$8,174	55%
All	$13,665.8	$25,662		$759.5	$1,426		$14,315.6	$26,699		$796.1	$1,485	

Tax As Percent of Adjusted Gross Income Full Year Residents 2010 and 2011						
	2010			2011		
Decile Group	Montana Adjusted Gross Income	Tax Liability	Tax / Income	Montana Adjusted Gross Income	Tax Liability	Tax / Income
	$ million	$ million	%	$ million	$ million	%
1	-$632.7	$0.0	0.0%	-$722.8	$0.0	0.0%
2	$301.8	$0.7	0.2%	$320.2	$0.8	0.3%
3	$560.0	$4.0	0.7%	$589.0	$4.3	0.7%
4	$833.3	$10.5	1.3%	$871.3	$11.0	1.3%
5	$1,129.5	$21.8	1.9%	$1,177.2	$22.6	1.9%
6	$1,469.6	$38.6	2.6%	$1,532.9	$40.0	2.6%
7	$1,882.6	$57.2	3.0%	$1,969.2	$60.2	3.1%
8	$2,392.7	$82.3	3.4%	$2,504.5	$87.2	3.5%
9	$3,165.0	$123.7	3.9%	$3,321.7	$131.6	4.0%
10	$8,075.4	$420.5	5.2%	$8,371.5	$438.3	5.2%
All	$19,177.2	$759.5	4.0%	$19,934.7	$796.1	4.0%

Business Structure and Taxation

A business legal ownership structure generally determines how the business income is taxed. Business organization is a matter of state law, and a business operating in Montana may be organized under the provisions of the laws of Montana (generally Title 35, Montana Code Annotated) or 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 business legal and financial liabilities. These structures have different mechanisms for decision making and control of the business's operations. They have different arrangements for sharing of income, expenses, risks and rewards among the owners. And, they offer different levels of privacy or transparency of ownership. How a business is organized also affects its ability to access capital markets. Most corporations and some types of partnerships can raise funds by issuing new shares and selling them, and existing shares can be bought and sold without requiring other owners' consent. With other business structures, buying and selling ownership interests or raising funds by bringing in new owners may require other owners' consent.

For taxation, the IRS code puts all businesses in one of three categories – disregarded entities, pass-through entities, or corporations (C corporations). Montana law generally requires a business to be in the same category for state taxation as it is for federal taxation.

Informally organized sole proprietor businesses are not treated as an entity separate from the owner for income taxation. Some formally organized businesses with a single owner are given the same treatment and are called *disregarded entities*. For these entities, there is no tax on income at the entity level, and in most cases the business entity is not required to file a tax return. The business income is reported on the owner's tax return and is taxed as part of the owner's income. For a sole proprietor business, the owner must be an individual or a married couple. For a disregarded entity, the owner may be an individual or another business entity. If the owner is another business entity, the disregarded entity is treated as if it were a division of the parent company for tax purposes.

In some cases, a disregarded entity that is owned by a non-resident or another business entity is required to file an annual information return showing the entity ownership.

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 non-resident 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 IRS 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 is his or her 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, this income is still taxable income to the owner based upon his or her 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 owners' 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 the owners. The owners are responsible for reporting this income on their tax returns and including it in the calculation of their taxable income.

A corporation not meeting the requirements to be treated as a pass-through entity, or not choosing 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. If the corporation's owners receive dividends, they must include the income in the calculation of their taxable incomes. A corporation can 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 following table shows characteristics of businesses falling into each of the four business tax categories.

Business Structure and Taxation				
	Individual	**Pass-Through Entity (S - Corporation or Partnership)**	**C - Corporation**	**Disregarded Entity**
Legal Business Organization	Informal	Partnership, Limited Liability Company (LLC), Corporation, Limited Partnership, etc.	Corporation	Single Member LLC, etc.
May be Owned By	One Individual or Married Couple	Individuals or Other Business Entities	Individuals or Other Business Entities	Individuals or Other Business Entities
Business Income and Owner's Income	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.
Distribution of Income to Owners	The business net income is the owner's income from the business.	Distributions to owners need not equal business' current net income.	Business pays dividends to shareholders. Dividends need not equal business' current net income.	Distribution to owner need not equal business's current net income.
Taxation	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 license tax. Owners taxed on dividends.	Entity is ignored. Business' income is taxed as owner's income.
Reporting	The business receipts and costs are reported on Schedule C of the owner's 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 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[1]. When a business operates in more than one taxing jurisdiction, each must decide how much of the business' 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 through its own lumber yards. 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[2] to allocate 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, with some placing more weight on one factor and less, or no, weight on the others.

[1]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.
[2]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.

If lumber production in Montana and lumber sales in North Dakota were separate, unrelated businesses which only operated within their respective states, 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 trees 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 lumber yards 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 lumber yard'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 lumber yard operations.

Transfer prices do matter to the states[3]. If the lumber mill charges high prices to the lumber yards, its Montana profits will be higher and the lumber yards' North Dakota profits will be lower. If the mill charges low prices, its Montana profits will be lower and the lumber yards' North Dakota profits will be higher.

Montana law addresses this problem through *combined reporting*. Affiliated companies 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 it 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. As income is passed through this chain to the individuals who are the ultimate owners, its original source may be lost. 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 pay New York or California income tax on Montana-source income -- income that should be taxed by Montana and not be taxed by the other state.

Montana law addresses this problem by requiring pass-through entities and disregarded 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 world-wide income and apportion a share to Montana, with one exception. A corporation or a group of affiliated corporations can make what is called a *water's-edge election*. When a corporate 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 U.S., 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 a country where the banking, tax, and corporation laws make it particularly easy to shift income from U.S. business operations to that country. 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.

Abusive tax shelters are arrangements where taxpayers mischaracterize either income or gains and losses in order to avoid taxes. While nothing about pass-through entities or tiered business ownership creates abusive tax shelters, individuals and corporations wanting to evade taxes have used the complexity that tiered ownership can create to try to hide or mischaracterize income.

[3]Transfer pricing also is important for the national-level taxation of international businesses. Much of the IRS's compliance work on international businesses involves trying to ensure that the transfer prices of inter-affiliate sales across national borders reflect actual economic values and are not being manipulated to shift income between countries.

Some abusive tax shelters involve pretending that monetary payments are not taxable income, but instead are a loan; or that in-kind compensation is a business investment. Another type of abusive tax shelter involves creating transactions with offsetting paper gains and losses; then recognizing the losses for tax purposes while claiming that recognition of the gains can be deferred indefinitely. In others, the claim is made that the losses were incurred by a taxable entity while the gains belong to an entity that is not subject to taxes in the U.S.

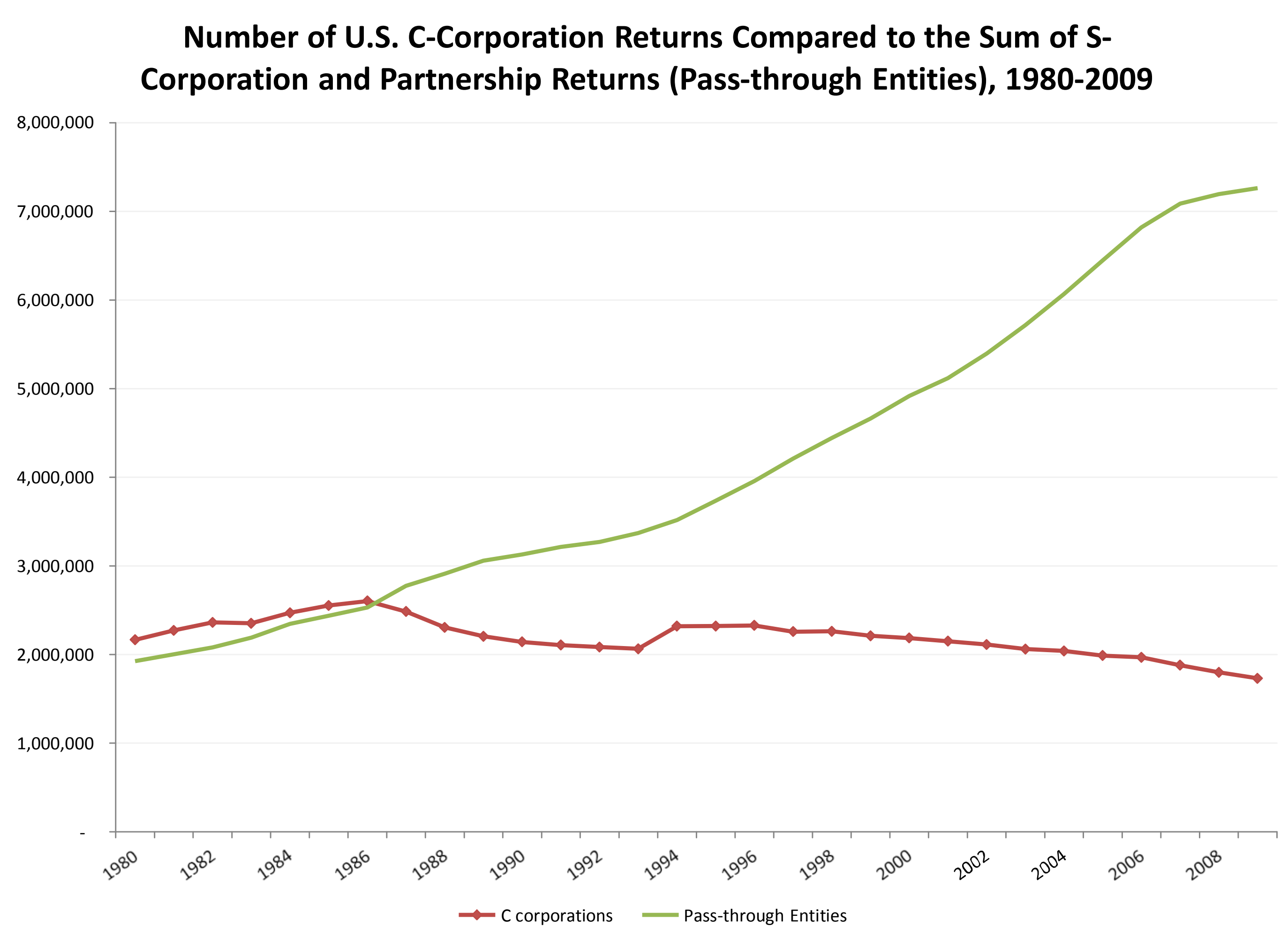
For example, one scheme involves creating a series of tiered business entities organized under the laws of several countries, with each passing its income to the next in line and the final entity paying the income to the owner but mischaracterizing it as a loan. The purpose of the tiered business structure in this case is just to make it too hard to track the money.

In another example, the taxpayer sets up three business entities. Two entities engage in offsetting financial transactions, such as buying and selling offsetting futures contracts. The third is set up in another country. When the two contracts are closed out, one will have a gain and the other will have an equal loss. The taxpayer recognizes the loss and uses it to offset other income. The entity with the gain is sold, at a nominal price that does not reflect the value of the gain on its futures contracts, to the non-U.S. entity, and then the taxpayer claims that the gain is not subject to U.S. taxes.

U.S. courts have consistently ruled that the types of sham transactions described above have no economic purpose other than evading taxes and should be ignored for U.S. tax purposes.

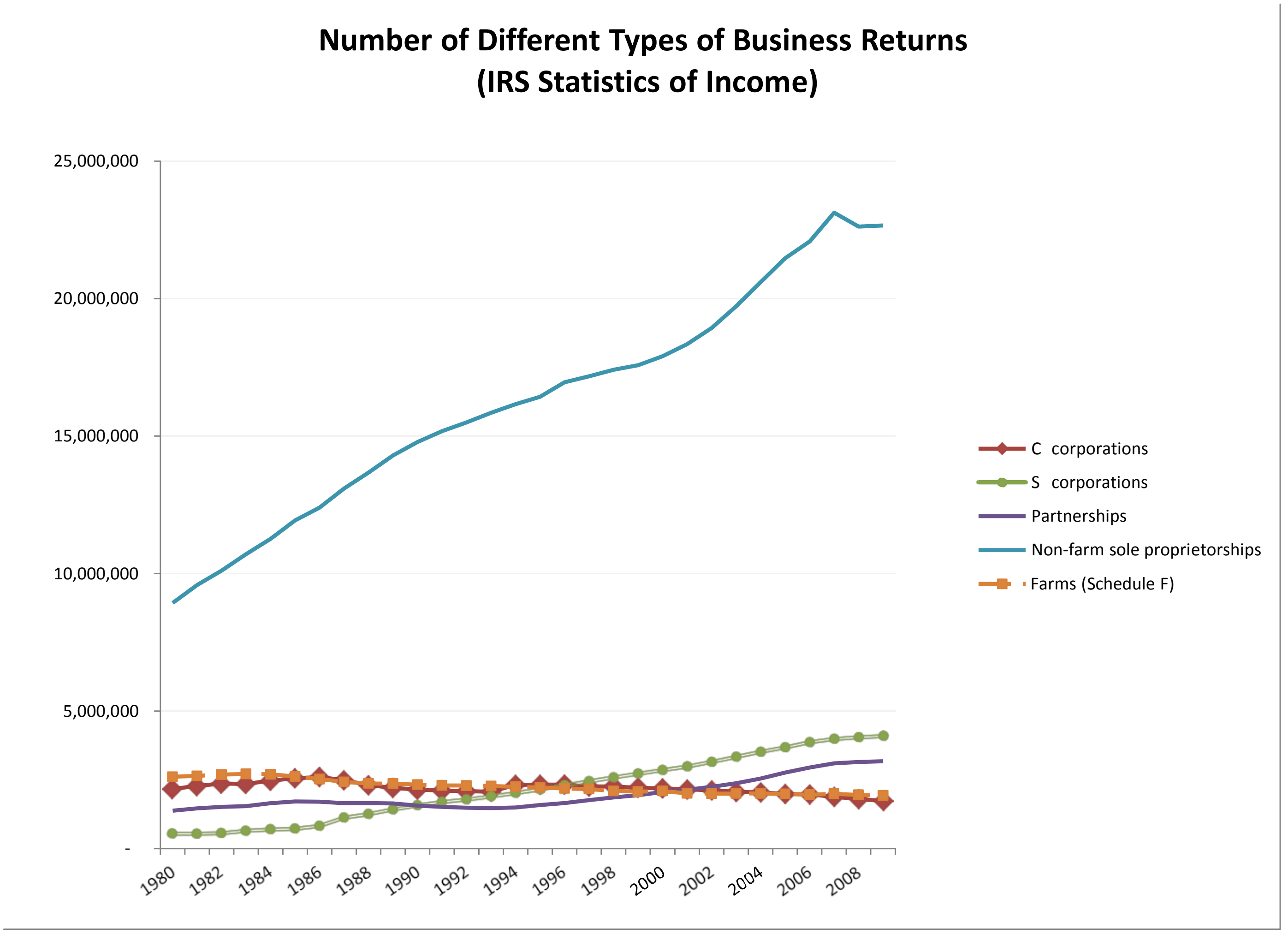
Growth of Pass-Through Entities

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 regular or C-corporations versus those filed by pass-through entities (partnerships and S corporations) from 1980 through 2009 (the graphs and history in this section are from Selected Issues Relating to Choice of Business Entity, Joint Committee on Taxation, U.S. Congress, July 27, 2012).



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 on the next page shows growth over the same period, 1980 – 2009, of all types of business organizations, including non farm sole proprietorships, S-corporations, partnerships, and farms filing using Schedule F.



As can be seen from the graph, non-farm sole proprietorships are the most common type of business entity in the U.S. based upon the number of returns filed. The number of non farm sole proprietorships has grown substantially – from 9 million in 1980 to almost 23 million in 2009.

Sole proprietorships, just as the name suggests, are businesses with a single owner and are a familiar sight on many Main Streets in Montana. The Department of Commerce in its publication, Economic and Demographic Analysis of Montana, December 2007 reported that over 60 percent of Montana businesses are sole proprietorships without any employees. The owner of a sole proprietorship will record his or her income on the state individual income tax form, Form 2 on line 12 as Business Income (or loss), and will attach a copy of federal Schedule C (or C-EZ), which has been filed with the taxpayer's federal tax return.

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 line 18 of the state individual income tax form (Farm Income or (loss)), and attaches a copy of federal Schedule F, which has been filed with the taxpayer's federal form. The number of farms filing under schedule F is also shown on the graph. The total number of farms in the US filing schedule F went from 2.6 million in 1980 to 1.9 million in 2009. However it should be noted that farms can also operate as partnerships or be incorporated as S-corporations or C-corporations.

During the same period, the number of C corporation returns declined, going from 2.2 million corporations in 1980 to 1.7 million in 2009. One thing to note is that C corporations in Montana seem to 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 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 one or more of the 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 went from 545,000 in 1980 to over 4 million in 2009, an annual growth rate of over 7 percent. Partnerships grew more slowly – increasing from 1.4 million in 1980 to 3.2 million in 2009.

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, going from 1,691 returns in 1980 to 14,778 returns in 2009.

Businesses of all sizes can be C-corporations or pass-through entities. Sole proprietor businesses generally are small. For 2008, the IRS reports that average receipts were $4.9 million for C-corporations, $1.9 million for partnerships, and $1.5 million for S-corporations, but only $58,000 for sole proprietor businesses. Many sole-proprietor businesses are part-time or a sideline for the owner. For 2011, 95% of taxpayers whose Montana income tax returns showed income or loss from a sole-proprietor business reported more income from other sources .

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

Pass-through entities classified as S-corporations or partnerships for tax purposes are required to file an information return each year. These 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 pass-through entities that can be owned by other business entities can elect to be treated as S-corporations for tax purposes. The following table shows the number of owners and the amount of income allocated to owners. This table shows information separately for owners who are resident and non-resident individuals and Montana and non-Montana business entities (based upon the business address provided).

Shares of Pass-Through Income by Owner Type

TypeofOwner	Number	%	$millions	%
Resident Individuals	71,806	33%	$1,361.90	62%
Non-Resident Individuals	92,423	43%	$404.60	18%
Montana Business Entities	9,080	4%	$160.60	7%
Non-MontanaBusinessEntities	42,632	20%	$275.90	13%
Total	215,941	100%	$2,202.90	100%

As can be seen in the table above, pass-throughs filing informational returns in Montana reported having 92,423 non-resident individuals as owners with Montana source income of nearly $405 million in 2010. Resident individuals are the second largest group of owners who show up on the pass-through returns (71,806 or 33 percent of all owners) with a reported $1,361.9 million in Montana source income. Just over nine thousand Montana business entities were listed as owners by pass-throughs on the informational returns, but more than 42,000 non-Montana business entities were owners of pass-throughs with Montana source income. The Montana business entities had $160.6 million in Montana source income; the non-Montana business entities had $275.9 million in Montana source income.

The next table in this section shows information from the same group of pass-through returns as in the table above, but splits the data into what was reported by S-corporations and what was reported by partnerships.

Montana Source Income by Type of Owner, 2010
Includes Income Allocated from First-Tier to Second-Tier Pass-Throughs
($ million)

	S-Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
Type of Owner	Owners	Income	Owners	Income	Owners	Income	Owners	Income
Resident Individuals	31,341	$733.7	4,525	$266.9	34,015	$321.6	1,925	$39.7
Non-Resident Individuals	3,147	-$1.8	15,357	$388.0	11,005	-$73.3	62,914	$91.7
MontanaBusinessEntities	2,288	$10.3	296	$18.6	6,166	$113.9	330	$17.7
Non-MontanaBusinessEntities	113	$21.5	2,224	$17.3	3,265	-$211.9	37,030	$449.0
Total	**36,889**	**$763.7**	**22,402**	**$690.8**	**54,451**	**$150.3**	**102,199**	**$598.1**

Net income from a pass-through entity's business operations is usually allocated to the owners as ordinary business income. Individual owners report this income on Schedule E of their federal tax returns and then report income from Schedule E on Line 17 of the Montana tax return. Income the pass-through entity receives from passive investments or the sale of assets is allocated to the owners as that type of income, and owners report it on the corresponding lines of their tax returns. For example, if a pass-through entity receives $1,000 of interest and allocates it equally to its 10 owners, who are Montana individuals, each owner should report the $100 of interest on Line 8a of their Form 2.

In both tables above, there are Montana and non-Montana business entities that have ownership shares in both partnerships and S-corporations. 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. The following table shows the number of returns, types of income, Montana adjustments to income, and deductions that were passed through to owners in 2010. Income and other items passed through two or more entities are only counted once.

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

Montana-Source Income Passed Through To Owners, 2010 Net of Distributions from First Tier to Second-Tier Pass-Throughs ($ million)	S-Corporations		Partnerships	
	Montana	Multi-State	Montana	Multi-State
Returns	21,415	5,780	16,842	4,599
Income Items				
Salaries and Other Fixed Payments to Owners	-$6.0	$11.6	$119.9	$25.2
Ordinary Business Income	$865.8	$365.0	$100.1	$281.0
Rental Income				
Real Estate	$13.7	$10.3	$72.9	$0.1
Other	$1.1	$5.3	$16.3	$12.9
Interest	$26.2	$10.6	$44.9	$25.8
Dividends	$8.1	$4.0	$50.7	-$3.5
Royalties	$8.7	$4.5	$21.1	$21.8
Capital Gains	$50.4	$30.0	$97.6	$44.0
Gains Taxed as Ordinary Income	$91.2	$54.0	$130.1	$160.3
Other Income	-$30.7	$2.5	$79.1	$8.8
Total	$1,028.6	$497.9	$732.7	$576.4
Montana Additions to Federal Income				
Interest on Non-Montana Municipal Bonds	$0.7	$0.5	$5.2	$0.3
State and Local Income Taxes	$1.9	$0.8	$0.2	$0.4
Other	$3.3	$0.5	$7.8	-$2.6
Total	$5.9	$1.8	$13.3	-$1.9
Montana Subtractions from Federal Income				
Interest on Federal Bonds	$10.4	$1.6	$1.2	$0.1
Purchases of Recycled Materials	$0.2	$0.0	$0.0	$0.0
Other	$73.8	$4.2	$223.9	-$4.7
Total	$84.4	$5.8	$225.1	-$4.6
Deductions				
Expensing of Capital Purchases	$179.6	$38.3	$80.9	$79.2
Contributions	$15.2	$6.7	$10.5	$1.4
Interest on Funds Borrowed to Make Investments	$9.3	$0.9	$15.2	$1.1
Other	$67.1	$5.2	$80.0	$28.4
Total	$271.3	$51.1	$186.5	$110.1
Total Net Montana Source Income	**$678.8**	**$442.8**	**$334.3**	**$469.0**

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, so 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, so 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 following table shows credits reported on pass-through entity returns for 2010. Credits actually claimed by owners are included in the credits claimed against individual income tax and corporation license tax.

Tax Credits Passed Through To Owners, 2010 Net of Distributions from First-Tier to Second-Tier Pass-Throughs				
	SCorporations		Partnerships	
Credit	Montana	Multi-State	Montana	Multi-State
Dependent Care Credit	$410	$70	$0	$5,080
College Contribution Credit	$7,887	$4,273	$1,759	$555
Insurance for Uninsured Montanans Credit	$114,435	$31,090	$23,650	$900
Credit for Investment in Recycling Equipment	$270,783	$137,271	$105,702	$84,080
Alternative Energy Production Credit	$0	$0	$1	$0
Contractors' Gross Receipts Credit	$1,413,772	$1,786,795	$122,064	$16,478
Alternative Fuel Credit	$0	$0	$0	$0
Infrastructure Users Fee Credit	$0	$0	$56,287	$0
Charitable Endowment Contribution Credit	$134,137	$18,404	$4,012	$12,000
Historic Building Preservation Credit	$14,227	$8	$195,780	$46,932
Increased Research Activity Credit	$122,911	$59,261	$19,105	$0
Mineral Exploration Credit	$0	$1	$0	$5,331,680
Empowerment Zone Credit	$11	$302,600	$0	$0
Film Production Credit	$28,697	$0	$0	$0
Biodiesel Blending Credit	$0	$4,560	$0	$0
Oilseed Crushing Credit	$5,401	$0	$0	$0
Insure Montana Credit	$1,679,771	$273,539	$256,531	$11,298
Temporary Emergency Lodging Credit	$4,500	$0	$0	$0
Total	**$3,796,942**	**$2,617,872**	**$784,890**	**$5,509,003**

Pass-Through Entities by Size

Number of Owners

Pass-through entities vary greatly in size. Two measures of company size that can be gleaned from pass-through returns are the number of owners and net income. These are not necessarily related. A company with large profits may have many owners, but it may also have only a few. Most pass-through entities have a small number of owners. The following table shows pass-through entities and their incomes grouped by the number of owners.

Pass-Through Entities - Number of Owners								
	S-Corporations				Partnerships			
Number of	Entities		DistributedIncome		Entities		DistributedIncome	
Reported Owners	Number	%	$ million	%	Number	%	$ million	%
1	12,634	47.6%	$703.6	49.0%	115	0.6%	-$21.8	-2.9%
2 to 3	11,273	42.4%	$354.1	24.7%	14,500	70.6%	$341.5	45.7%
4to8	2,114	8.0%	$251.8	17.5%	4,267	20.8%	$106.7	14.3%
9 to 20	399	1.5%	$86.3	6.0%	919	4.5%	$118.1	15.8%
over 20	148	0.6%	$39.5	2.8%	724	3.5%	$203.2	27.2%
Total	**26,568**	**100%**	**$1,435.3**	**100%**	**20,525**	**100%**	**$747.8**	**100%**

As the table shows, more than 90 percent of both S-corporations and partnerships have eight or fewer owners. Over 90 percent of S-corporation income is earned by entities with eight or fewer owners, but over two-fifths of partnership income is earned by entities with more than eight partners. Over four-fifths of entities with more than 20 owners are partnerships. S-corporations are limited to no more than 100 shareholders, while there are types of partnerships with one or a few active partners who run the business and many partners who are passive investors

Montana Source Income

The following table shows the number and percentages of pass-through entities in six groups based on the entity's Montana source income.

Number of Pass Through Entities by Amount of Montana Source Income

	S-Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
Montana - Source Income	Number	%	Number	%	Number	%	Number	%
$0 or Negative	7,959	37.1%	2,171	37.5%	7,975	47.3%	2,245	48.5%
$1 to $10,000	3,565	16.6%	1,736	30.0%	2,800	16.6%	1,177	25.4%
$10,001to$100,000	7,948	37.1%	1,245	21.5%	4,562	27.0%	773	16.7%
$100,001 to $1,000,000	1,865	8.7%	552	9.5%	1,395	8.3%	329	7.1%
$1,000,001to$5,000,000	95	0.4%	73	1.3%	120	0.7%	74	1.6%
Over $5,000,000	14	0.1%	11	0.2%	18	0.1%	28	0.6%

As can be seen from the table above, many S-corporations and nearly half 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 – falling into the over $5 million category. Twenty five S-corporations (14 plus 11) and 46 partnerships (18 plus 28) reported more than $5 million in Montana source income. The next table shows total Montana source income reported by pass-through entities for the same groupings as in the prior table.

Montana Source Income by Size of Pass-Through

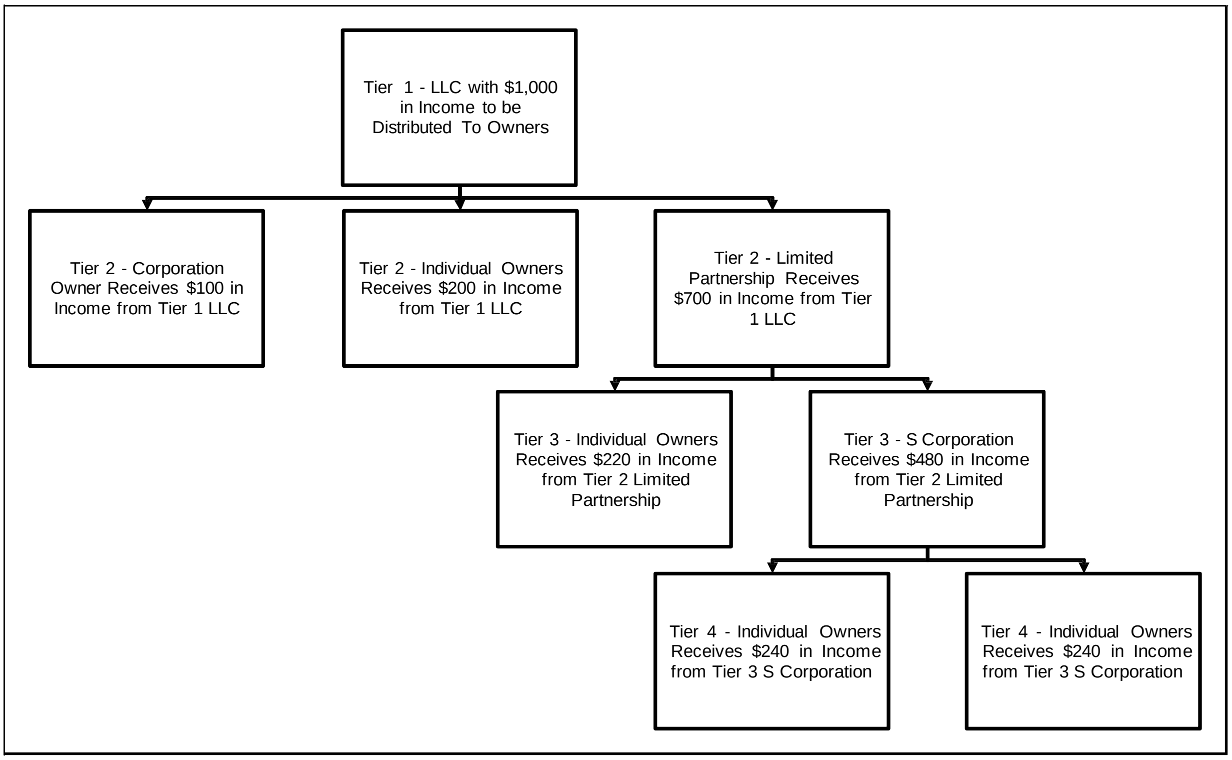
	S-Corporations				Partnerships			
	Montana		Multi-State		Montana		Multi-State	
Montana - Source Income	$ million	%	$ million	%	$ million	%	$ million	%
$0 or Negative	-390	-49.2%	-69	-15.8%	-835	-320.7%	-295	-57.8%
$1 to $10,000	15	1.9%	4	1.0%	11	4.3%	3	0.6%
$10,001to$100,000	298	37.7%	48	10.9%	172	66.2%	29	5.6%
$100,001 to $1,000,000	430	54.3%	164	37.5%	366	140.5%	95	18.6%
$1,000,001to$5,000,000	175	22.1%	138	31.5%	234	90.0%	157	30.7%
Over $5,000,000	264	33.3%	153	34.9%	312	119.8%	522	102.3%

Tiered Ownership and Tax Administration

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 statues. 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, then the LLC is treated as a branch by the IRS. The taxpayer must be consistent in its state filing 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 is not itself 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 either corporate, individual and/or another pass-through entity as a partner, owner or shareholder, they represent a challenge for tax administration. The diagram above shows how complex even a comparatively small set of ownership/partnership relationships can become.

A pass-through entity with Montana source income must file an informational return. If this entity has a partner, shareholder, member or other owner who is a non-resident individual, foreign C-corporation, **or** a pass-through entity with an owner/shareholder that is a nonresident individual or foreign C-corporation, the pass-through entity is also required to file with the state an agreement with the individual nonresident to timely file a Montana return, pay taxes and be subject to personal jurisdiction of the state with respect to the income from the 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 (15-30-3313, MCA).

Overview of Corporate License Tax

Montana's corporate license is a franchise tax levied on C corporations for the "privilege of carrying on business in this state" (15-31-101(3), MCA). A corporation includes:

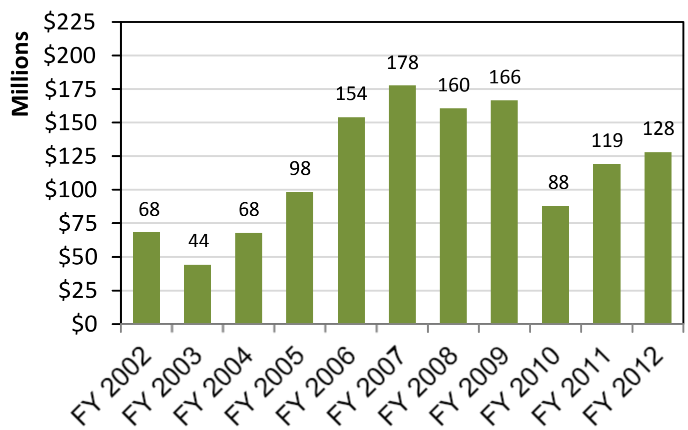
> *an association, joint-stock company, common-law trust or business trust that does business in an organized capacity, all other corporations whether created, organized, or existing under and pursuant to the laws, agreements, or declarations of trust of any state, country or the United States, and any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

Every bank organized under the laws of Montana or another state or under the United States and every savings and loan organized under state law or United States law is also subject to corporate license tax (15-31-101(4), MCA).

The table below shows total corporate license tax collections for fiscal years 2002 through 2012. As a rule, corporate income tax collections in Montana follow the general national economy. Total collections in FY 2002 (which started on July 1, 2001) were $68.2 million, increasing to $177.5 million in FY 2007 and declining to $87.9 million in FY 2010. FY 2011 and FY 2012 corporate tax revenues were $119 million and $127.8 million respectively.

Corporate License Tax

Fiscal Year	Total Revenue
FY 2002	$68,173,254
FY 2003	$44,137,518
FY 2004	$67,722,940
FY 2005	$98,213,717
FY 2006	$153,675,069
FY 2007	$177,503,707
FY 2008	$160,351,862
FY 2009	$166,357,514
FY 2010	$87,906,411
FY 2011	$119,045,890
FY 2012	$127,774,092



Corporate license taxes, other than fees for applications for film production credits, are deposited in the state general fund.

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

Corporate License Tax Collections and Refunds - General Fund

Fiscal Year	Payments With Returns	Estimated Payments	Audits, Penalties, and Interest	Refunds	Total Collections
FY 2008	$39,473,130	$127,433,439	$16,874,522	($23,439,304)	$160,341,787
FY 2009	$45,608,755	$109,585,667	$31,041,454	($19,881,362)	$166,354,514
FY 2010	$36,909,143	$72,732,614	$15,380,337	($37,121,182)	$87,900,911
FY 2011	$23,747,579	$98,979,556	$26,116,467	($29,799,712)	$119,043,890
FY 2012	$27,777,649	$110,864,886	$27,885,386	($38,757,329)	$127,770,592
Average	$34,703,251	$103,919,232	$23,459,633	($29,799,778)	$132,282,339

As can be seen from the table, estimated payments is the largest source of corporate tax collections followed by payments with returns. Average estimated payments were $103.9 million over the five years. Average revenue over the five years was $34.7 million for payments with returns. The five year average of audits, penalties and interest was $23.5 million, and refunds averaged $29.8 million per year.

In 2005 the Legislature passed the Big Sky on the Big Screen Act which provides tax credits that can be used to reduce income taxes for certain costs of production of motion pictures, documentaries, television programs, commercials and magazine advertising. However, in order to receive the tax credits, a production company must apply to the department and pay an application fee. The fee is $500 and is deposited in a special revenue account. The revenue in the special revenue account is statutorily appropriated (17-7-502, MCA) - half to the Department of Revenue and half to the Department of Commerce for administration of the provisions associated with the tax credit. The Act terminates on January 1, 2015.

Corporate License Tax Collections - Film Production Credit Application Fee

Fiscal Year	Film Production Credit
FY 2008	$10,075
FY 2009	$3,000
FY 2010	$5,500
FY 2011	$2,000
FY 2012	$3,500

Who pays Corporate License Tax?

Only C corporations pay corporate license 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 corporate license tax purposes. Despite the filing requirement, subchapter S corporations do not pay Montana corporate license 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/shareholder reports any taxable income on their individual income tax form. S corporations are discussed in the section on taxation of business income preceding this section.

Returns Filed for Tax Year 2010

Regular C Corporations	16,167
S Corporations	27,234
Total Corporations	43,401
C Corporations Paying Minimum Tax*	10,971
C Corporations Paying More Than Minimum Tax	5,196
Total C Corporations	16,167

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

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. Other entities exempt from corporate license 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 non-profit organizations. Unrelated business taxable income, as defined by federal law, of exempt organizations which creates more than $100 of federal tax liability is taxable as corporate income in the same manner as other taxable corporate income. In order to receive treatment as exempt from state corporation taxes, the corporation must prove it is in compliance with all statutory conditions (15-31-102, MCA and ARM 42.23.103).

Research and development (R&D) firms organized to engage in business for the first time in Montana are not subject to the corporate license tax for the first five years of operation. In order to receive this tax treatment the firm must apply to the Department of Revenue and be approved as meeting legislative requirements (15-31-103, MCA).

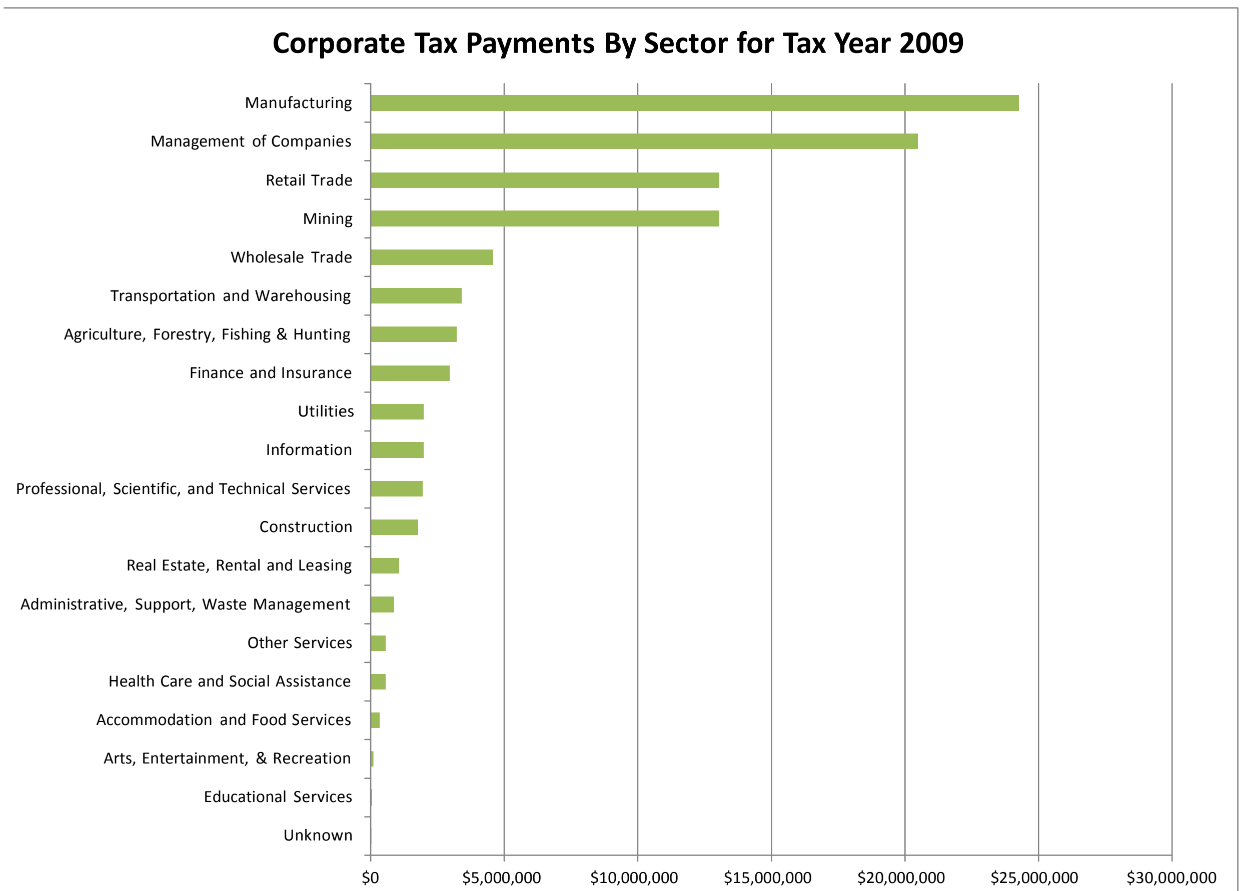
Distribution of Corporate License Taxes

The following table shows the distribution by Montana tax liability of the 15,262 corporate returns with a Montana tax liability filed in calendar years 2010 and 2011 reporting on tax year 2009. Altogether the top 100 returns constituted about 73 percent of total tax liability for the group and the top 500 returns accounted for 90 percent of total Montana tax liability for the group. The other 14,762 returns accounted for only 10.0 percent of the total Montana tax liability.

Corporate Returns Filed in CY 2010 - CY 2011 for Tax Year 2009
Distribution of Montana Tax Liability

Regular Corporation Returns	Number	Tax Liability	Percent of Total Liability	Cumulative Percent of Total Liability
Top 100 returns	100	$70,185,073	73%	73%
Second 100 returns	100	$8,005,602	8%	81%
Third 100 returns	100	$4,033,143	4%	86%
Fourth 100 returns	100	$2,445,527	3%	88%
Fifth 100 returns	100	$1,693,348	2%	90%
All other returns	14,762	$9,771,185	10%	100%
Total	15,262	$96,133,878	100%	n/a

Another way to look at the distribution of corporate income taxes is by sector. Starting with the 2009 tax returns, taxpayers are asked to identify their industry, just as requested on their federal tax forms. The following graph shows the general distribution of corporate license taxes by sector.



The largest sector in terms of total taxes paid was manufacturing, followed by management of companies, and then retail trade. The Census Bureau list of manufacturing activities 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. Management of companies includes bank and other holding companies and corporate or regional headquarters.

Only businesses organized as C corporations pay corporate license taxes; businesses in different sectors may be more likely to use different forms of business organization, such as partnerships or S corporations. These structures are called pass-through entities because under most conditions, income from the business is passed through to the owners or shareholders of these businesses, who then must report the income on their own tax returns. These structures are discussed in the taxation of business income section.

Taxable Income and the Tax Rate

The starting point for calculating Montana corporation license tax is the corporation's federal taxable income. In order 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. Then after additions and reductions, income is apportioned to Montana to produce Montana taxable income.

If the corporation conducts business that is taxable only in Montana, then all of the net 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 conducting business that is taxable both in and outside the state are required to apportion income to Montana based on an equally weighted, three-factor apportionment formula. Sales, property and payroll comprise the three factors used in the apportionment formula. The payroll factor is the ratio of payroll paid in compensation 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. The tax is normally levied at a rate of 6.75 percent on net income apportioned to Montana, with exceptions explained below.

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
Sales In Montana		**Total Sales**		**Sales Factor**
$4,000,000	÷	$100,000,000	=	0.040
Apportionment Factor (Avg.)				**0.052**

In the table to the left is an example showing how a multi-state corporation doing business in Montana would calculate its Montana source income. The corporation has $1 million in payroll in Montana out of total payroll of $10 million dollars. It has $2 million of property in Montana out of total property of $125 million. It 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. If this corporation had total taxable income of $10,000,000, then its Montana taxable income is $520,000 ($10 million x 0.052 =$520,000), and its state income tax is $35,100 before credits ($520,000 x 6.75%).

Relying on an apportionment formula simplifies the calculation of taxable income by state for the multistate taxpayer and for the state tax administrator, but there can still be issues. A simple example is that of a multistate 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 such as Nevada. Apportioning too much in sales or property or payroll to Nevada 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 only 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. 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, and who do not own or rent real estate or tangible personal property, and whose annual gross income from sales in Montana does not exceed $100,000 may elect to pay an alternative tax equal to one half of one percent of gross sales.

There is a minimum tax of $50 for any corporation doing business in the state. The table on returns filed for Tax Year 2010 earlier in this section shows that for those returns filed in FY 2010 by corporations, the minimum tax was paid on 10,971 returns or almost 68 percent. If the corporation has no property, sales, or payroll in the state during the tax period, it is exempt from the minimum tax.

Montana net operating losses (NOL) of the corporation may be carried back for a period of three years and used to reduce prior year income, and may be carried forward for a period of seven years to reduce income in those future years. The table below provides a comparison of Montana treatment of net operating loss deductions with that in other states.

Like Montana, Utah provides a three year carryback of net operating losses, but has a limit of $1 million. Utah allows losses to be carried forward up to 15 years. 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 Losses

		Allowed years of carryforward					
		5 years forward	**7 years forward**	**10 years forward**	**12 years forward**	**15 years forward**	**20 years forward**
Allowed years of carryback	**0 years back**	Arizona Arkansas Nebraska New Mexico Rhode Island		Kansas Michigan New Hampshire 5/ Vermont	Illinois 3/	Alabama Minnesota North Carolina Oregon Tennessee Wisconsin	California Colorado Connecticut District of Columbia Florida Iowa Kentucky Maine 4/ Massachusetts New Jersey **North Dakota** Ohio Pennsylvania 7/ South Carolina
	2 years back						Alaska Delaware 1/ Georgia Hawaii **Idaho 2/** Indiana Maryland Mississippi Missouri New York 6/ Oklahoma Virginia West Virginia 9/
	3 years back		**Montana**			Louisiana Utah 8/	

1/ Delaware has a $30,000 per year limit on carrybacks.
2/ Idaho limits carrybacks to $100,000 in the preceding 2 years.
3/ Illinois has suspended use of NOLs for tax years beginning in 2011-2014.
4/ Maine suspended certain carryforwards for tax years 2009-2011.
5/ New Hampshire limits carryforward of losses generated per year to $1 million.
6/ New York limits carrybacks to the first $10,000 of losses.
7/ Pennsylvania has a $3 million limit for taxable years.
8/ Utah has a $1 million limit on carrybacks.
9/ West Virginia limits carrybacks to $300,000.

Source: *2012 State Tax Handbook*, CCH, 2011.

All states with a corporate income tax allow some form of carryforward of losses, but many do not allow carryback of net operating losses. Thirty states do not allow carryback of net operating losses, but do allow carryforward of losses, from ficve years up to 20 years. Thirteen states allow the same carryforward and carryback periods as federal tax law has historically allowed (two back and 20 forward). Louisiana, Montana, and Utah allow corporations with net operating losses to carry back these losses against the three prior years of income.

Credits

As with individual income tax, corporations with expenditures that qualify can claim tax credits. The table below shows what credits have been claimed in the last two fiscal years and the number of corporations claiming those credits.

Montana Corporation Tax Credits

Credit	--- Tax Year 2009 --- Number of Credits	Total Credit Amounts	--- Tax Year 2010 --- Number of Credits	Total Credit Amounts
Contractors Gross Receipts Tax Credit	90	1,318,876	91	906,127
Charitable Endowment Credit	30	94,889	14	42,830
Montana Recycling Credit	*	41,560	*	47,884
Credit for Increasing Research Activities	24	250,195	21	372,491
Credit for Contribution to MT University or Private College	22	4,466	25	5,605
Temporary Emergency Lodging Credit	-	-	-	-
Health Insurance for Uninsured Montanans Credit	43	30,319	42	31,753
Credit for Alternative Fuel Motor Vehicle Conversion	*	6,004	*	14,000
Alternative Energy Production Credit	*	50	*	100
Dependent Care Assistance Credit	-	-	-	-
New/Expanded Industry Credit	-	-	-	-
Historical Building Credit	-	-	-	-
Infrastructure Users Fee Credit	*	520,271	*	501,904
Mineral Exploration Incentive Credit	*	25	*	25
Film Production Credit	-	-	-	-
Film Employment Refundable Credit			*	11,110
Biodiesel Blending and Storage Credit	-	-	-	-
Oilseed Crushing and Biodiesel Production Credit	-	-	-	-
Geothermal System Credit	-	-	-	-
Insure Montana Credit	177	1,002,347	185	942,979
EmpowermentZoneCredit	-	-	-	-
TotalCredits	**402**	**3,269,002**	**391**	**2,876,809**

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 a *.

Estimated Payments

Companies with a tax liability of $5,000 or more have to make quarterly estimated payments. Tax returns for taxpayers using a calendar year as their fiscal year are due May 15th. 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. Taxpayers must use the same tax period as was used on the federal tax return. Automatic extensions are allowed for up to six months following the prescribed filing date.

Comparison of State Corporate Tax Rates

Maximum Corporate Tax Rate By State From Highest to Lowest - Tax Year 2012

Rank	State	Maximum Tax Rate
1	Iowa *	12.00%
2	Pennsylvania	9.99%
3	District of Columbia	9.975%
4	Minnesota	9.80%
5	Illinois	9.50%
6	Alaska *	9.40%
7	New Jersey	9.00%
7	Rhode Island	9.00%
9	Maine *	8.93%
10	California	8.84%
11	Delaware	8.70%
12	Indiana	8.50%
12	New Hampshire	8.50%
12	Vermont *	8.50%
15	Maryland	8.25%
16	Louisiana *	8.00%
16	Massachusetts	8.00%
18	Wisconsin	7.90%
19	Nebraska *	7.81%
20	Idaho	7.60%
20	New Mexico *	7.60%
20	Oregon	7.60%
23	West Virginia	7.50%
23	Connecticut	7.50%
25	New York	7.10%
26	Arizona	6.968%
27	North Carolina	6.90%
28	**Montana**	**6.75%**
29	Alabama	6.50%
29	Arkansas *	6.50%
29	Tennessee	6.50%
32	Hawaii *	6.40%
33	Missouri	6.25%
34	Kentucky *	6.00%
34	Georgia	6.00%
34	Michigan	6.00%
34	Oklahoma	6.00%
34	Virginia	6.00%
39	Florida	5.50%
40	North Dakota *	5.20%
41	Mississippi *	5.00%
41	South Carolina	5.00%
41	Utah	5.00%
44	Colorado	4.63%
45	Kansas	4.00%

As of Jan. 1, 2012, Federation of Tax Administrators

Penalties and Interest

Corporations who do not pay a tax when due may be assessed 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. Interest on unpaid tax accrues at a rate of 12 percent per year, or at one percent per month or fraction of a month on the unpaid tax.

Comparison of Corporate Tax Rate with Other States

Forty four states and the District of Columbia have a tax on corporate income. The table to the left uses data from the Federation of Tax Administrators (as of January 1, 2012) to show the maximum rates for states that have a corporate tax. These go from 12 percent down to four percent.

A number of states have a graduated income tax which is indicated by an asterisk next to the state.

Nevada, Washington and Wyoming do not have corporate income taxes. Texas imposes a franchise tax based on gross revenues. South Dakota has a tax on financial institutions only. Ohio has adopted a commercial activity tax which is a tax on gross receipts.

Montana's tax rate is 6.75 percent. Idaho's tax rate is 7.6 percent and North Dakota's corporate income tax rate is 5.2 percent. As discussed above South Dakota does not have a general corporation income tax, but 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. As noted above, Wyoming does not have a corporation income tax, but does have a corporation franchise or license tax of $0.0002, which applies to the sum of capital, property, and assets located in Wyoming (in addition to a general property tax), and also has a relatively broad-based sales tax.