PO BOX 201706
Helena, MT 59620-1706
(406) 444-3064
FAX (406) 444-3036

Revenue and Transportation Interim Committee

62nd Montana Legislature

TO: Committee Members

FROM: Jaret Coles, Staff Attorney

RE: Administrative Rule Activity

DATE: September 16, 2011

Department of Revenue

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http://revenue.mt.gov/formsandresources/administrative_rules/default.mcpx

Notice of Proposed Rules:

Corporate License Tax -- General and Corporate Multistate Activities. MAR 42-2-863. A public hearing was held on July 21, 2011, and the public comment period ended on July 29, 2011. The Department proposes to adopt two new rules, amend 25 rules, amend and transfer one rule, transfer three rules, and repeal two rules. The first proposed new rule provides direction to corporate taxpayers on the ability to utilize net operation loss deductions when a different filing method is used, such as a change resulting from nonrenewal of a water's-edge election or a change in filing from separate to combined. The second proposed new rule informs the public of the Department's current practice regarding reorganizations of water's-edge taxpayers. The proposed amendments generally revise corporate tax definitions and procedural steps including calculation of gross receipts, the definitions of business and nonbusiness income, allocation and apportionment of income, and the perfection and revocation of a water's-edge election. The proposed repeals are housekeeping in nature and deal with outdated and repetitious language.

Reduction of State Mark-Up On Liquor Sold by the State -- Senate Bill No. 215 (2011). MAR 42-2-865. A public hearing will be held on September 27, 2011, at 9:00 a.m. in the Third Floor Reception Area Conference Room, Mitchell Building, Helena. The public comment period ends on September 30, 2011. The Department proposes to adopt one new rule and amend the definition of vendor in one rule.

The proposed new rule states that it implements Senate Bill No. 215 (codified at section 16-2-211, MCA), which was signed into law on May 6, 2011, with an immediate effective date. Senate Bill No. 215 provided that "[b]ased upon the percentage of Montana-produced ingredients that are used in producing liquor, the department shall reduce the liquor markup charged by the department in determining the wholesale price of the liquor. To qualify for a reduced markup, the liquor must have been manufactured, distilled, rectified, bottled, or processed by a distillery that produces 25,000 proof gallons or less of liquor nationwide annually." A Montana-produced ingredient is defined as "an agricultural product, either processed or unprocessed, that in its unprocessed state was grown in Montana or, if it is a processed ingredient, that was processed in Montana from unprocessed agricultural products that were grown in Montana." The proposed new rule states that for "purposes of applying 16-2-211, MCA, the department will assume that for distilleries that manufacture, distill, rectify, bottle, or process 25,000 proof gallons or less of liquor nationwide annually, all ingredients contained in the liquor from such distilleries is comprised of 100 percent Montana-produced ingredients. A reduced mark-up rate of 20 percent will be applied to liquor products from such distilleries." The proposed new rule sets out a registration procedure for a distillery to request a reduced mark-up rate and the Department will apply the reduced mark-up rate for qualifying products on November 1, 2011.

Comment: A copy of Senate Bill No. 215, the Governor's message regarding Senate Bill No. 215, MAR 42-2-865, and a legal memoranda from Legislative Services is attached. The proposed new rule does not follow the language set out in Senate Bill No. 215 since all distillers who produce 25,000 proof gallons or less are assumed to qualify for the reduced markup, regardless of whether Montana-produced ingredients were used. Additionally, the proposed new rule implies that a distiller cannot receive the reduced markup until November 1, 2011, despite the immediate effective date of Senate Bill No. 215.

It is the Department's position that the proposed new rule allows the Department to take the preventative measure of protecting the state from a potential violation of the interstate commerce clause in the U.S. Constitution. This potential issue was disclosed by the Department to Senate Finance and Claims and House Appropriations, after which the bill was amended to include a nonseverability clause. The Department's concern regarding the potential violations of the interstate commerce clause are persuasive and there is no guarantee that the nonseverability clause would save the state from paying damages to large multistate and multinational distillers. According to one estimate, the potential damages would amount to approximately $9 million for every year the incentive is in place. Nonetheless, it can be argued that under the separation of powers doctrine the Judicial Branch is the only branch of government that has the authority to determine whether a particular legislative act is constitutional, not the Executive Branch or the Legislative Branch.

Property Tax -- Validating Sales Information and Extension of Statutory Deadline for Assessment Reviews -- Senate Bill No. 295. MAR 42-2-866. A public hearing will be held on September 19, 2011, at 3:00 p.m. in the Third Floor Reception Area Conference Room, Mitchell

Building, Helena. The public comment period ends on September 23, 2011. The Department proposes to adopt one new rule, amend one rule, and repeal one rule. The proposed new rule provides that a taxpayer can file an informal review using Form AB-26 in any year of the appraisal cycle. The proposed amendment provides that the Department will consider sales involving financial institutions, auction sales, and short sales in distressed markets if the transactions comprise more than 20% of sales in a specified area in accordance with International Association of Assessing Officers (IAAO) standards. The proposed repeal eliminates an obsolete rule.

Property Tax -- Aggregation of Property Tax For Certain Property -- Implementation of Senate Bill No. 372. MAR 42-2-867. A public hearing will be held on September 19, 2011, at 1:00 p.m. in the Third Floor Reception Area Conference Room, Mitchell Building, Helena. The public comment period ends on September 23, 2011. The Department proposes to amend two rules. The first proposed amendment provides a method for determining how to allocate the reduced rates for class eight property so that each taxing jurisdiction is treated equitably, it defines a relationship test for determining what is meant by an affiliated entity or a family member, and it provides for an increased tax rate of 3% (as opposed to 2%) or the denial of the exemption for failure to comply with reporting requirements. The second proposed amendment clarifies definitions in response to the first proposed amendment.

Comment: Senate Bill No. 372 provides for the reduction of the class eight property tax rate from 3% to 2% for the first $2 million of market value of class eight property owned by an individual or business. The $2 million bracket threshold is raised to $3 million and the tax rate is reduced to 1.5% the first year after corporation and individual income tax collections exceed the prior year's collection by more than 4% (starting in fiscal year 2013). All class eight property above these thresholds continue to pay the current rate of 3%.

As enacted, Senate Bill No. 372 does not expressly provide for an increased tax rate of 3% for individuals or businesses that do not comply with the Department's reporting requirement. However, the proposed rule provides that a taxpayer cannot obtain the benefit of the lower rate for property that exceeds that threshold by withholding information the Department needs to determine the total amount of the statewide property the taxpayer owns, controls, possesses, or manages directly or through an affiliated entity that is over the threshold. In other words, the proposed rule places the burden on the taxpayer to prove entitlement for the reduced rate instead of obtaining a benefit for the failure to report.

One relevant statute (section 15-8-309, MCA) provides that a taxpayer who fails to report property "must be assessed a $25 penalty". Additionally, in a statute that is not relied on in the proposed rule (section 15-8-306, MCA) the Department has authority to assess property at a rate not exceeding 10 times its value for any property willfully concealed, removed, transferred, or misrepresented by the owner or agent. Given the Department's duty to make sure taxpayers are in compliance with the law combined with the complexities of determining what is an affiliated entity, there is an argument that the proposed rule is in compliance with the relevant statutes. However, this committee or the legislature may desire to introduce legislation that specifically

increases the tax rate to 3% in order to provide further legal authority.

Notice of Adopted Rules:

Housekeeping Rules -- Property Tax. MAR 42-2-861. Amended two rules and repealed four rules on July 29, 2011. No public comments were received. The amendments delete a reference to 15-7-133, MCA, since it was repealed. The repealed rules apply to 2006 property tax refunds.

One-Stop Business Licensing. MAR 42-2-862. Adopted amendments to two rules as proposed on August 12, 2011. No public comments were received. The Board of Review, through the Department of Revenue, amended two existing rules regarding one-stop business licensing. The first amendment provides a website address and phone number for the Department's call center in order for a business to obtain a guide for filing applications. The second amendment updated the responsibilities of the Board of Review and the Department of Revenue.

Department of Transportation

Notice of Proposed Rules:

None as of September 8, 2011.

Notice of Adopted Rules:

None.

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