



Revenue and Transportation Interim Committee

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

59th Montana Legislature

SENATE MEMBERS

GREGORY BARKUS
JERRY BLACK
JIM ELLIOTT
KIM GILLAN
SAM KITZENBERG
KEN TOOLE

HOUSE MEMBERS

JILL COHENOUR
CYNTHIA HINER
BOB LAKE
DAVE MCALPIN
PENNY MORGAN
KARL WAITSCHIES

COMMITTEE STAFF

JEFF MARTIN, Lead Staff
LEE HEIMAN, Staff Attorney
DAWN FIELD, Secretary

MINUTES

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division.

Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.

June 17, 2005

Capitol Building, Room 137
Helena, Montana

COMMITTEE MEMBERS PRESENT

SEN. JERRY BLACK
SEN. JIM ELLIOTT
SEN. KIM GILLAN
SEN. SAM KITZENBERG
SEN. KEN TOOLE

REP. JILL COHENOUR
REP. CYNTHIA HINER
REP. BOB LAKE
REP. DAVE MCALPIN
REP. PENNY MORGAN
REP. KARL WAITSCHIES

COMMITTEE MEMBERS EXCUSED

SEN. GREGORY BARKUS

STAFF PRESENT

JEFF MARTIN, Lead Staff
LEE HEIMAN, Staff Attorney
FONG HOM, Secretary

Visitors

Visitors' list, [Attachment #1](#).

COMMITTEE ACTION

- Elected Sen. Jim Elliott as chair and Rep. Karl Waitchies as vice chair.
- Appointed Sen. Kim Gillan and Rep. Bob Lake to attend meetings of Quality Schools Interim Committee and to report to this committee.
- Agreed to write a letter to Montana's congressional delegation and a letter to the state of Wyoming regarding funding for the repair of the Beartooth Highway.
- Adopted proposed work plan.
- Voted unanimously to allow proxy votes.

CALL TO ORDER AND ROLL CALL

Sen. Jim Elliott called the meeting to order at 8:00 a.m. Secretary conducted a voice roll call. ([Attachment 2](#)) Senator Barkus was absent.

DEPARTMENT OF TRANSPORTATION REPORTS

JIM LYNCH, Director of Department of Transportation, discussed federal reauthorization of transportation funding and the repair of the Beartooth Highway.

Reauthorization

Mr. Lynch said that work on reauthorization started in 2001 with almost 70 different congressional committee meetings. Those meetings laid the groundwork for the new reauthorization bill. The president signed seven extensions to TEA-21 which expired September 30, 2003. The president signed a one-month extension in May.

The Senate introduced a bill in 2005 that would provide \$294 billion in funding, while the House bill proposed spending \$283 billion. The House version would provide \$1.8 billion to Montana over a six-year period. The Senate bill would provide \$2.1 billion to Montana. The Senate bill would increase funding to the Department of Transportation by \$200 million.

REP. WAITCHIES asked if the state could still request additional funds that other states did not use. **MR. LYNCH** said that right now the money belongs to those states. It was a way of actually increasing the amount of funding under the new reauthorization with attempts to persuade the president to provide more than the House funding.

Beartooth Highway

JIM LYNCH distributed a document showing the damage of the Beartooth Highway ([Exhibit 1](#)).

On May 20, highway crews working to open the Beartooth Highway observed some slide activity in their area. Aerial photographs showed extensive damage to the highway. The Federal Highways Administration was notified and an emergency plan was put into action that

could help Montana with costs. The department would have to repair the highway under normal highway funding if it was not an emergency action.

Because the Beartooth Highway is a historic highway, the project was given national interest. We asked our congressional delegation whether we needed to declare an emergency to get federal funding and we were initially told that we did not. Landslide Technologies out of Portland, Oregon, evaluated the damage and proposed a plan to repair the highway. The Transportation Commission authorized the department to proceed with emergency procedures to rebuild the highway rather than go through the normal process. The Montana Department of Transportation sent out a Request for Proposal to contractors. At a meeting with the community of Red Lodge, we told them that the costs of repairing the Beartooth Highway would be somewhere around \$20 million and construction would be done by October 15 of this year. The department expected quite a few bids but received only one bid package. The department and the Federal Highways Administration evaluated the bid package and recommended to award the contract to Kiewit Western of Littleton, Colorado. JTL Group and HK Engineering, both from Billings, will also work on the project.

Governor Brian Schweitzer declared the Beartooth Highway to be a state of emergency the following Wednesday after the slides. That enable MDT to receive emergency road funds. The department has received a \$2 million advance on the estimated \$2.4 million.

Mr. Lynch said that money was earmarked years ago for the Beartooth Highway and some went to Wyoming. The Wyoming share could be transferred to Montana and administered by FHA. Mr. Lynch said that if FHA administered the project, it would be hard to get that money refunded so that the work on the Wyoming side can be completed at a later date.

Mr. Lynch said that if the state doesn't receive additional federal funding, funding for the project would have to come out of the state program. The question is whether funding would come from the Billings financial district or from the five financial districts in the state.

Mr. Lynch said he informed the Transportation Commission that if state funding is required, that would be considered a statewide event and probably should be shared by all five financial districts, but that would be the Transportation Commission's decision.

Mr. Lynch thinks the state will receive emergency relief funding of some sort. Another possibility is putting an earmark in the federal reauthorization bill to handle the Beartooth. The risk of an earmark is that it could take it away from our funding amount, which means we would be decreasing our funding and paying for it ourselves out of our state program. If the earmark is additional to funding, it would compete with other earmarks.

SEN. GILLAN asked that given the uncertainty of how much money we're going to get and how much the total project will cost, is the contract up to a certain amount? **MR. LYNCH** said that this is not typical contract because the extent of the damage is not known, and we can't wait months and years to design the fix and go through the processes you would normally go through.

SEN. GILLAN asked if there will be MDT people on the highway. **MR. LYNCH** said that this will be a Montana Department of Transportation project and project managers, project engineers, inspectors will be onsite.

SEN. GILLAN asked if any of the existing MDT equipment would be used on the project. **MR. LYNCH** said that they will not be used because the project will be turned over to the contractor.

SEN. McALPIN asked if we can gauge the likelihood of more damage occurring and do we understand what caused it and is there a likelihood that it will happen again. **MR. LYNCH** said that has been taken under consideration. He believes the damage started at the top of the summit when rain was absorbed by the wet snow to the point that it exceeded the strength of the cornice dams on the top and when those dams broke, water found an exit and created the slides. One thing that will be done is addressing the drainage.

SEN. BLACK asked if the closure is going to have a big impact on Red Lodge, what is being done to alert motorists nationwide about an alternate route, and can you address the concerns that Senator Story wrote about regarding the possibility of other priority projects being delayed in that area due to repairing the Beartooth? **MR. LYNCH** said that MDT is working with the community, putting up signs and distributing publication within the state. The Office of Economic Opportunity, AAA, and the Chamber of Commerce is also notifying people that Red Lodge is not closed. Regarding Senator Story's letter, we have five financial districts and every financial district submits a list of priorities to the Transportation Commission to vote on projects. The Beartooth Highway is a priority. It is anticipated that this will not affect the priorities of other projects that we have now.

REP. LAKE asked if there is going to be any significant costs to upgrade alternate routes? **MR. LYNCH** said he did not think so.

SEN. ELLIOTT said that Senator Story suggested that the Committee might be able to help in getting some federal funds. Do you view that as anything we could do? **MR. LYNCH** said that the Committee could help by writing letters to MDT and the congressional delegation, telling them that you support the effort that the MDT is taking in looking for emergency relief funding, that it is the only way that Montana can repair the Beartooth Highway without impacting the state. **SEN. ELLIOTT** asked if Wyoming is impacted by this, is there an opportunity to ask

Wyoming, not for financial help, but for legislative help. MR. LYNCH said that Wyoming is concerned and has stepped forward and offered support on this project.

JIM CURRIE, Deputy Director of Department of Transportation, presented a report on the funding structure with the Federal Aid Program (Transportation Equity Act for the 21st Century).

There are several categories of federal funding: bridge funding, interstate maintenance funding, national highway system funding, surface transportation program (STP) funding, and congestion mitigation air quality (CMAQ) funding. In terms of project selection and priority, all projects are approved by the Transportation Commission. There are three broad methods of project selection and prioritization. For bridge, interstate, national highway system, part of the STP program and part of the CMAQ program, the projects within those categories are primarily approved by the Commission and the information that the Commission used to determine what type of projects, where those projects should be, and when they should be comes off an asset management system. This system tells us and the Transportation Commission when we should be spending dollars on a section of highway and what that fix should be.

In 1999, the Legislature changed the way the state deals with secondary highways. The Department of Transportation took jurisdiction over any paved secondary highway; prior to that it was done by the counties. The prioritization and selection method was done using a team within each financial district and that team was made up of one county commissioner in each county in that financial district. The projects are selected by the county commissioners within the financial district. These selected projects are then put to the Transportation Commission. Once those priorities are set, it then assigns funding to the financial districts according to highest priority and working downward. The funding allocation is dictated by state statute [60-2-306, MCA].

The urban program is a separate category that is allocated to urban areas. The local government of the urban area sets the priorities in their districts for what those urban projects would be. Those recommendations are also made to the Transportation Commission.

An important thing to remember is that these project selections, no matter what system they are on, are based on information that comes out of MDT's asset management systems. Those asset management systems are updated on an ongoing basis.

Adjourn at 9:00 to join Legislative Finance Committee's meeting.

MEETING WITH LEGISLATIVE FINANCE COMMITTEE (see LFC's minutes)

ELECTION OF OFFICERS

SEN. TOOLE's nomination of Sen. Elliott as chair was approved unanimously by voice vote. SEN. BLACK's nomination of Rep. Waitchies as vice chair was approved unanimously by voice vote.

SEN. ELLIOTT discussed how he anticipates running the meetings. He prefers that party politics not play a role in the committee. He addressed the issue of proxy votes. He said that proxy votes discourage members from attending meetings and that someone who has not heard discussion on an issue should not be voting. **REP. COHENOUR** said that the last committee that she was on allowed proxies because they didn't want anything to go out of committee that was not a unanimous decision. **SEN. ELLIOTT** said that the committee is governed by the Joint Rules of the House and the Senate. Consensus is nice, but often hard to achieve. He thinks a majority vote can send an issue out of the committee. **SEN. TOOLE** prefers proxies because people are busy and sometimes cannot be present to vote; proxies will enable us to get work done. **SEN. GILLAN** said it is difficult to attend every meeting due to conflicts and if you are unable to attend, you could have discussions ahead of time. **SEN. GILLAN** said that without objection, she would go with proxies also.

REP. LAKE moved to allow proxy votes, seconded by Rep. Cohenour; motion passed unanimously.

PROPOSAL FOR COMMITTEE LIAISON WITH QUALITY SCHOOLS COMMITTEE - SENATOR KEN TOOLE

SEN. TOOLE said that one of the concerns that he has had on the education debate is making sure that members of this committee are being informed of what is going on with the lawsuit, funding of schools relating to the tax system, and how money is being raised. He would like to have a person from the committee attend all Quality Schools Interim Committee meetings and give a report to the Revenue and Transportation Interim Committee of those meetings.

SEN. GILLAN asked Sen. Toole if this person or persons would attend all meetings, or just making a point of being able to attend each of our meetings and update everyone? **SEN. TOOLE** said that it would be someone attending the meetings and presenting a 10 minute report at our meetings.

REP. LAKE asked Sen. Toole if he had talked to the Quality Schools Committee about what role a member of this committee would play on the Quality Schools Committee. **SEN. TOOLE** said that he has not talked to anybody, but that someone from this committee would attend the meetings and get information for this committee.

SEN. ELLIOTT said that attending Quality Schools Committee meetings would necessitate expenses and feels that there should be two members attending, one from each party, and the availability of staff to go to those meetings. **JEFF MARTIN** said the schedule for Quality Schools Committee is June 28, July 21, August 19, September 19, and two unspecified dates in November. If two members attended each of the meetings, that would be the equivalent of one full committee meeting of this committee. You could appoint a subcommittee to sit in on the Quality Schools Committee meetings; give a report at the RTIC's September 30 meeting; finish their work in November; and then give a report for the scheduled meeting in December. He had talked with Connie Erickson and she would be willing to make reports to this committee.

SEN. ELLIOTT asked that if we were to fund it, would it preclude us from having another meeting, or any kind of travel? **MR. MARTIN** said that the committee has an allocation of \$39,000. Last interim, the committee spent \$22,000 of a \$32,000 budget. This budget is based on full attendance, and taking into account certain assumptions about travel time and lodging expenses.

REP. WAITCHIES said that he did not see any point in appointing a liaison because we do not meet that often to get reports. He would rather have staff give us the minutes, and not have someone telling us what they thought they heard or what they believe in, telling us what it was, when it may or may not be factual. **SEN. TOOLE** said that he hoped that as this committee is working on the revenue estimates, that we are not thinking that we're going to do the revenue estimate in one meeting in December. That information is important for whatever solution is proposed in December. I think this is different than a normal interim for the tax committee because we know that we're going to have a special session and we also know that the tax committees are going to have a major role in terms of revenue estimates. I think it would be good if we had more than just a staff report.

REP. LAKE said that he didn't think that the Quality Schools Committee is close to having real numbers and deciding the funding formula. They probably will have three or four meetings before they even get to that point. I would suggest that we do not appoint anyone but if Sen. Toole would like to attend and pass on information, I suspect that I will as well, but only as it progresses to the point where there is going to be some information to be dealt with. **REP. LAKE** suggested revisiting that topic at a later date.

SEN. GILLAN asked Rep. Lake if there is a deadline for numbers in October? **REP. LAKE** said that the committee is to have a funding formula and a distribution formula ready by then. We are not committed to having the funding in place until 2007. The funding formula is supposed to be ready for the court by October. So it will be the structure rather than the entire dollars. **MR. MARTIN** said that Connie Erickson might be able to give the committee a rundown of what the schedule is going to be for the committee.

SEN. TOOLE moved that the committee designate one member to be a liaison to the Quality Schools Committee and that person use his or her own judgment about how many meetings to attend and the level of information, but that person would be a regular agenda item to present information.

CONNIE ERICKSON, research analyst for Legislative Services Division and lead staff for the Quality Schools Interim Committee, gave a brief overview of what the QSIC has been doing.

SEN. ELLIOTT said the question before the committee is whether this committee designates someone to attend the Quality Schools Interim Committee meetings to gather information and report back to the Revenue and Transportation Committee. **MS. ERICKSON** said that the QSIC is looking at the funding side, but also keeping in mind the taxation side of it. OPI is working in that particular area and at the July 21 meeting, OBPP is scheduled to discuss the state's fiscal capacity and tax equity within school districts. Tax equity is one of the issues that makes it difficult for some school districts to consolidate.

REP. WAITCHIES asked Ms. Erickson about the funding mechanism for schools. **MS. ERICKSON** said that discussion will start probably on July 1. She is not sure how much will be done identifying revenue sources. That really is not the charge of the Committee. The charge of the Committee is to come up with a new school funding model, but members of the committee are aware of the revenue side of it, but how much we will get into it is uncertain. They are on a deadline of the first of October and have to have something to report to the Supreme Court on October 1.

SEN. TOOLE revised his motion to designate Sen. Gillan as the liaison.

SEN. ELLIOTT said he cannot support Sen. Toole's motion because it is only one member. If Sen. Toole would like to expand his motion to include Rep. Lake and if he would serve, he would support it. **SEN. TOOLE** moved to designate two individuals, Rep. Lake and Sen. Gillan to be liaisons to the Quality Schools Committee to report back to the committee.

REP. WAITCHIES said that he reluctantly supports that motion but has reservations about getting third-hand information. He would rather get information directly, and so he would still appreciate having someone from QSIC or Ms. Erickson give a report.

REP. LAKE said he would serve but has lukewarm support for the motion. He questions whether revenue sources will be discussed in detail.

Motion of Sen. Toole was approved unanimously and Rep. Lake and Sen. Gillan were appointed.

DEPARTMENT OF REVENUE REPORTS

DAN BUCKS, Director of Revenue, presented property tax protests for three entities: PPL Montana, Omimex Canada, and Montana Dakota Utility Resources Group (MDU). (**Exhibit 2**)

PPL Montana

MR. BUCKS said that there are two cases involving PPL Montana. One covers tax years 2000, 2001, and 2002, and one is a pending appeal of 2003 and 2004 before the State Tax Appeals Board (STAB). Most of his comments dealt with the 2000 - 2002 case, which was appealed to STAB after a lengthy mediation process. STAB reached a decision in mid-February, 2005. STAB reduced values and taxes by approximately 9% over the three-year period. STAB increased the value for 2000, and then decreased it by 14% in 2001 and 2002.

MR. BUCKS said that PPL Montana is centrally assessed property, and as with other property, there are three major approaches that are available for valuation: the cost approach, the income approach based upon the discounted value of a future stream of income, and the market or comparable sales approach.

There were important legal issues presented to STAB. First, PPL Montana contended that their property should not be centrally assessed. STAB held in favor of the Department on that issue. Second was whether the Department had properly backed out of the value of intangible property. The default provision of 10% of the value of the property was used. STAB ruled in favor of the Department on that. Third was valuation of pollution control equipment. Again, STAB upheld the Department on that issue.

However, STAB did change the valuation. The Department used a 90% weight on a cost approach, and a 10% weight on the income approach. In valuing centrally assessed property, as much as a 50% weight is assigned to the income approach. In this case it was only 10%. STAB changed the valuation for 2000 by using what it determined to be the sales price when PPL purchased the properties in 1999. In 2001 and 2002, STAB took the income approach out. STAB reaffirmed that it generally approved of the use of the income approach, and if you go through STAB's rulings, it likes the income approach in many different contexts. It decided that the income approach was correct for 2001 and 2002 because those were the years of the California energy crisis when Enron and others had manipulated prices in the west. PPL Montana was not involved in the manipulation but it benefitted from high energy prices. The Department had put only a 10% weight on the income approach because of the price spike. MR. BUCKS said that it was appropriate to reduce the income approach, because the price spike certainly affected the value of their property and their return of investment for those years. We felt that some modest weight was appropriate and we were disappointed that STAB had

removed it entirely.

SEN. ELLIOTT asked Mr. Bucks if STAB considered the income approach in 2002 valuation.

MR. BUCKS said that they took it out for 2001 and 2002, but they noted that they felt that the income approach was a valid method to use, particularly for centrally assessed property. STAB determined that the 1999 sales price was the starting value in 2000 based on their interpretation of the purchase price.

REP. WAITCHIES asked what happens in 2003. **MR. BUCKS** said that STAB has not heard the appeal for 2003 and 2004, but all of these issues will come back for those years. The recurring nature of the issues is a major reason why I chose in March to appeal the STAB decision. **REP. WAITCHIES** asked, if there is a court ruling, will that affect all the decisions for the future from STAB? **MR. BUCKS** said the decisions can provide some guidance but each year of valuation stands on its own. The department believes that the property should be centrally assessed and that is handling the intangible property and the pollution control equipment correctly. The department also believes that a combination of cost and income approach is appropriate for these properties in the typical instance, and their valuations will be based on some mixture of it. The department would probably put an increasing weight on the income approach in the future because the California energy crisis is over. The department's approach will not change much, but the final court decisions that are clear are more likely to affect their practices. One of the reasons the department sought a court review is to confirm the understanding on some of these basic issues because they are going to recur. Clear court decisions will give guidance to both the taxpayers and the department.

Another major issue is an equalization issue raised by PPL Montana. PPL Montana believes that as an electric wholesale generator, it should have its properties compared to other utilities that sell into regulated markets. The department disagreed with that. PPL Montana is selling into unregulated markets and that the utilities are selling into regulated markets. STAB did not resolve that issue because it is a constitutional issue.

The department appealed the decision on March 10 for three reasons. First, there are some fundamental issues arising out of deregulation. Mr. Bucks said that it is better to have court guidance for everyone, sooner rather than later. He hopes that will reduce the litigation in the future by providing clear guidance, particularly on central assessment. Central assessment versus local assessment would have a huge impact on valuation. Second, there were indications that PPL Montana was interested in settlement discussions. You can't settle that which is not under dispute. Mr. Bucks was interested in pursuing a settlement over a long period of time: the five years that are under dispute and for some future period to improve cash flow problems of the counties and reduce the risks and costs of litigation. He wanted to make clear that he can enter into a settlement only to the extent that it reasonably conforms to market

value. The department has a duty to establish the valuation of properties on the basis of market value except for those that are valued on a productivity basis, and that is their clear guideline. Third, disagreement with the decision to disallow the income method for 2001 and 2002.

MR. BUCKS said that total taxes assessed against PPL Montana for the first three years (2000-2002) was \$14.7 million. PPL Montana protested \$7.7 million of that amount. Mr. Bucks presented a pie chart that showed the protested amount in 10 counties. Mr. Bucks said that whatever is not paid by PPL Montana is shifted to residential and business taxpayers, including agriculture unless the local government finds a way to reduce its expenditures. There is a substantial amount of money at stake in terms of potential impact on other taxpayers. MR. BUCKS noted that Rosebud County has a higher percentage of its tax base tied up at 25% for the first three years. Rosebud County has very low mill levies and the impact does not play out in quite the same way as some of the other counties.

REP. LAKE said Omimex protested 75% of its property taxes, MDU protested 17.9%, but PPL Montana is scattered all over the board, from no protested amount to a high of 66.9%. What is the difference in their property that would change the protested percentage? Is there a different type of property involved that you accept one way and they go along with? MR. BUCKS said that he cannot account for the company's choice of what they protest but he thinks generally they did not protest in which a smaller amount is at stake. For example, in Stillwater County, Gallatin County, and Flathead County, the total amounts involved were relatively small. If you look at the other counties, it basically breaks down principally as hydro power versus coal fire. The percentages they protested seemed to have varied between the hydro power counties and the coal counties. That was their choice as to how to protest and what they paid into protest and it varied from year to year.

REP. LAKE asked if the method for valuing the property of the three companies is the same? MR. BUCKS said no. The general methods that are used, cost, income, and market are the basic approaches. Both the weighting will vary in terms of the other properties. The data is summarized on one sheet for handy reference. The answer is the same approach is not used in every specific case. These are simply numbers and treat them as numbers for your reference as to the impact of one county to another.

REP. COHENOUR said that even though PPL MONTANA wasn't directly involved in the price manipulation, it benefitted during the energy crisis, and so to understand why STAB would want to remove that as an assessment tool at all seems a little strange to her. MR. BUCKS said that STAB considered those to be years that were an aberration because the earnings were so high. We agree that those were unusual years, but we didn't think that it should be taken out of consideration. We took account of those years being unusual by reducing the weight on the

income method significantly. We still think that the income they earned affected the value of the property in those years, and to say that it didn't have an effect is just going too far.

SEN. ELLIOTT said that he was surprised that STAB didn't at least include a base line income approach. Perhaps there was no base line to measure because of the sale. **MR. BUCKS** said he wanted to be circumspect on this. The valuation discussion in the STAB decision is not easy to follow and doesn't provide a clear precedent.

MR. BUCKS clarified the status of PPL MONTANA. The Department of Revenue appealed in Cascade County. A week later, PPL Montana appealed in Lewis and Clark County for the same case. There were motions in Lewis and Clark County as to whether that would proceed. Judge Sherlock firmly agreed with the department that the action in Lewis and Clark County should be dismissed and that the case should proceed in Cascade County. **MR. BUCKS** said he hopes PPL Montana will not appeal Judge Sherlock's decision. If there is a continued effort to change the venue in this case, their avenue would be an appeal to the Supreme Court that would take a year. **MR. BUCKS** said that would be an unnecessary delay. Judge Sherlock ruled that Cascade County was perfectly equipped to hear all the issues before that court. The department is also pursuing settlement discussion with PPL Montana. There were discussions on March 31 and April 1. It was a constructive discussion but the parties were far apart. **MR. BUCKS** said that he could not accept the proposal that was made in good faith by PPL Montana because it would result in a set of values over a period of years that would not be defensible as being a reasonable range of market values and the department would not be performing its duty under statutes if it accepted the offer. We made our own proposals. The company has indicated that they wish to continue discussions. We have written in reply that our door is open and we will continue settlement discussions at the same time that the appeals go forward.

MR. BUCKS said there are two large natural gas pipeline protest cases. These arise out of federal and state deregulation of the natural gas industry. The major issue in these cases is whether the properties are to be centrally assessed or locally assessed. That is a dimension that is different from the PPL case. It's a question of whether they fall into the classification that the Legislature has established where the tax rate is 12%, or whether they fall into the business equipment rate at 3%. What is at stake is a difference by a factor of 1 to 4 in the amount of taxes.

The Omimex case is in process. They purchased in part properties of another company, Encana, which the Department reached a settlement in December of last year. That was before my tenure and I cannot reflect in detail on that. Omimex owns the Encana properties and also acquired other properties that are listed in the summary provided (**Exhibit 3**). Part of the issue here is whether the department's centrally assessed administrative rule is valid. In the

Encana case, a judge in the Hi-line has ruled that the rule is valid. We are hopeful that Judge Sherlock would rule in the same manner. This litigation is now going forward. The trial is scheduled before Judge Sherlock beginning December 12. Out of a total Omimex taxes of \$908,400; \$681,300 has been protested. Omimex filed a declaratory judgment action in court so it skipped over STAB, although there is a formal appeal pending in STAB, but the issues are being heard in the district court.

The MDU property tax protest ([Exhibit 4](#)) for 2004 is before STAB and the issues are similar with respect to local assessment versus central assessment. The total dollars assessed are \$8.69 million; the amount in protest is \$1.55 million. MDU has more value involved in this than just simply that natural gas pipelines.

REP. MORGAN asked Mr. Bucks who is on the State Tax Appeals Board. **MR. BUCKS** said that the Board is a 3-member body appointed by the Governor on a staggered cycle for a set number of years and terms. The Legislature confirmed one of the members who was reappointed by Governor Martz and Governor Schweitzer appointed a new member who was also confirmed this last session.

SEN. ELLIOTT said that the Omimex issue is before the courts. Is the issue the Department's rule on how centrally assessed property is determined? He is curious because this is one of the study issues that will come before this committee. He asked when and if it will be decided by the court. **MR. BUCKS** said that the Omimex case is scheduled for trial. It goes beyond just the Department's rule. It's the question of whether properties of this type should be centrally assessed. It is scheduled for trial beginning in December and we expect a decision in early 2006.

Mr. Bucks said there are the two methods for resolving property tax disputes. There is the appeal and litigation method and there is the settlement method. The appeal and litigation method in these large and complex cases takes time. The Department can also settle cases. The standard is: the Department cannot typically in settlement arrive at results where it doesn't believe that it can defend it in the reasonable range of market value. Whether that's always been the standard in the past, he is not sure. Are there circumstances that may dictate other results? Perhaps.

The Department in the past faced criticism when litigation lasted for extended periods of time. Likewise, they face criticism when they settle cases. The statute, which is the market value requirement and the reasonableness in terms of interpreting that standard. Those are the two guiding principles and you have to weigh those constantly in terms of making decisions about litigation and settlement.

OVERVIEW OF THE REAPPRAISAL OF AGRICULTURAL AND FOREST LAND - Randy Wilke, Department of Revenue

MR. RANDY WILKE presented his report on the Reappraisal of Agricultural Land and Forest Land (**Exhibit 5**). Agricultural land valuation is composed of three parts. The first is to determine the classification or use of the land. Is it farm land, grazing land, or irrigated land? The second part is to determine the productivity or yield to the land; bushels of wheat, tons of alfalfa. The third part is to apply valuation schedules against each acre of land based on its use and yield.

Historically, the department has been in decent shape with respect to determination and valuation schedules, in large part, due to the Agricultural Advisory Committee providing solid direction with respect to the valuation formula, and the data that should be used in the formula.

The classification and yield determination may be the largest challenge. The department has not completed a comprehensive review of Ag land use and yield in 40 years. That's a real problem because the law says that that needs to be kept current and by not complying, we are at risk of litigation. The department has not been budgeted to perform that adequately; but last session it was provided budget authority to begin that process.

The department made three proposals. The first involved reducing the number of land use types of farmland, grazing, irrigated, crop and hay land to farmland and grazing and people were not in favor of that idea. The second proposal would require new staff, and visiting with each producers would be expensive, in the neighborhood of \$3 million and that proposal was not endorsed by the Legislature. The department scaled back the approach and received a more favorable response. That approach has several elements: 1) ongoing discussion and involvement of all affected Ag groups and Ag producers; 2) keep the existing five agricultural land use types as described; and 3) heavy reliance on technology and available information from the Natural Resources Conservation Service and land use information from the Farm Service Agency.

The department would like to generate maps to be mailed to each producer that would show ownership, land use(s), and productivity or yield estimates for those acres. The department plans to take the next year or so to get all the information in order to do ground proofing and secure direction from Ag groups and producers.

The department plans to wait until 2009, the time when reappraisal values will be placed on the tax roll, to put any reclassification or new productivity schedules determined during the project on the tax roll.

Mr. Wilke also discussed the draft time line found in the handout.

OTHER DOR TOPICS

MR. BUCKS presented a report (**Exhibit 6**) on Tribal Agreements. The department entered into a new revenue sharing agreement with the Crow Tribe for cigarette and tobacco taxes. The department will hold a public hearing on July 6, 2005, with the Blackfeet Tribe on updating their agreement to lengthen the term to 10 years, provide for a revocation clause that conforms to state law, and revise their payments reflect the current tax rates. The department is actively seeking agreements with other tribes in the areas of oil and gas to eliminate double taxation on some reservations. There are other tribes that are interested in a cigarette and tobacco agreements, and the department is actively trying to interest tribes in that. The Blackfeet wish to update their alcohol agreement, as well as the motor fuels agreement. One change in this administration is that it is no longer pursuing tribal agreements on a department by department basis. The Governor has established a council chaired by Budget Director David Ewer, and policy staff member, Anna Whiting-Sorrell, and other staff in the Governor's Office and the Budget Office to provide central guidance and to raise the level of communication with the tribes.

Administrative Rules

The department has provided a report as to subject areas that we are working on. The one rule that has been noticed that is a housekeeping matter in the property tax area; and secondly, a set of rules that we are working on to implement statutory changes made in the last session of the Legislature. There will be other rules that are under development in the department, but these are the ones that I wanted to call your attention to at this time.

We are doing a number of things in the department to try to change the relationship between the department and the citizens. One thing we want to do is to thank taxpayers for doing the right thing. We are also willing to admit our own errors and to invite continuing input. We are rewriting all of our communications in the Department to make them more understandable and also to take the opportunity to always say thank you when the occasion arises to thank a citizen or a tax practitioner for doing right thing or for helping make the tax system work better.

Number 2, if we make a mistake, we will apologize.

Number 3, as much as possible, we are going to convert correspondence from notices to letters that have people's name on them and contact people for followup.

The last area is the area of compliance. We are currently readying followup on 150 abusive tax

shelter cases involving out of state corporations and/or nonresidents that we have identified. There are no Montana residents involved. A report from the Permanent Subcommittee on Investigations, finalized in April, entitled "The Role of Professional Firms and the U.S. Tax Shelter Industry", which named names and cited problems of tax sheltering that were illegal and abusive. Mr. Bucks passed out news articles, one from Wall Street Journal and one from the New York Times, (**Exhibit 7**) reporting that KPMJ admitted engaging in unlawful tax shelters. What is the impact to Montana by the tax shelters that out of state corporations engage in? Montana suffers monetary damages because of abusive tax sheltering amounting in untold millions of dollars.

REP. LAKE asked Mr. Bucks if he thinks that his change and aggressive tax collection policies will give him the result of the unexplained increase in the personal and corporate income tax? **MR. BUCKS** said that a quick answer is that they have just started to address those questions. In terms of the returns received this past year, they have not had much impact from increased compliance. He noted the fact that the department with the support and funding of the Legislature in the August 2002 session, had funded some additional compliance positions that have been very productive and helpful. In terms of actively managing the department's resources for compliance and the additional resources provided in the last session, we don't see the impact. He is skeptical that the current legal tools are adequate to curb all the problems that are out there.

UPDATE ON INTEGRATED REVENUE INFORMATION SYSTEM - Randy Wilke

MR. WILKE said that the Integrated Revenue Information System (IRIS) will be completed on July 1. Specific testing on individual parts of that system to be completed by August 5 with total system testing by September 16. Training on the system will be completed by the end of September. Complete conversion to IRIS will occur the first of October, 2005, and then fully launching the system thereafter.

Phase II will include a small liquor warehouse distribution tax system. Whereas the old system is outdated and is in danger of having no support. The new system is on target for implementation by December 15, 2005.

The completion of Phase III will allow the department to completely move out the POINT system by December 31, 2006.

REP. McALPIN asked about the life expectancy of this program and about the planning process for the next program. **MR. WILKE** couldn't tell him the life of these particular systems, but it's typically 10 years to 20 years.

REP. LAKE asked if the taxpayer will see a change when the conversion is made. **MR. WILKE** said the difference would be that it would work better.

COMMITTEE RESPONSIBILITIES, PROPOSED WORK PLAN, BUDGET, MEETING SCHEDULE (Exhibit 8)

Jeff Martin and Committee Staff summarized the draft Committee work plan:

- Statutory duties
- Statutorily required reports
- Assigned interim studies
- Other topics
- Budget and meeting schedule
- Administrative rule review

Following a discussion of the committee's revenue estimating duties, the Committee asked questions to Terry Johnson, Legislative Fiscal Division's principal analyst.

REP. LAKE asked that in order to put something meaningful in front of the special session, how much time would it take to do a revenue estimate? **MR. JOHNSON** said that he intends to review all revenue estimates. Whether we provide all of that detail to the committee would depend on the conclusions that we came up with. The reason for that is that we feel that having good information is important for the special session in order to distinguish between one-time versus permanent revenue. We want to make sure that we do the best job that we can. During a normal cycle, we usually start by about the first of September, and for a staff of four people, we devote almost 100% of our time until about the first of November.

REP. LAKE asked that considering Director Ewer's comments at the joint meeting that the previous administration and this administration looks at those estimates, anything in excess of what was determined in the regular session as being a one-time source and that's the way they would plan on the utilization of that money, would you see the need for us to devote that amount of time? **MR. JOHNSON** said that that is difficult to answer. First issue is, if that were the direction collectively as a legislative body, then there wouldn't be a need to spend so much time on that provided that we don't see any significant downward trends. But the secondary issue is that there are other issues that could surface besides just school funding and Director Ewer alluded to that today, especially dealing with retirement systems that might create the need to look at revenue more closely. I think there is some need to look at the revenues in detail.

REP. LAKE asked if it would be better to do a general overview with a detailed analysis on some of the significant sources? **MR. JOHNSON** said that when he talks about looking at every

source, some of those sources are not very large and obviously if you had a 10% error rate in some of those smaller sources, it will not amount to a lot of dollars. Our focus would be on individual income tax and probably the corporation tax.

REP. WAITCHIES asked Mr. Johnson if he was expecting to bring Dr. Paul Polzin before that revenue estimate or just to give us an insight of what the economy in general is doing? **MR. JOHNSON** said that that hasn't been discussed, but bringing in Dr. Polzin into the discussion, as well as Dr. Myles Watts, makes sense.

SEN. ELLIOTT said that it is an interesting and fine distinction between one-time revenue and ongoing revenue in some areas, what kind of parameters would a person put on that? **MR. JOHNSON** said he tried to highlight in his document specifically with oil and gas prices. He was concerned about the fact that we were having a one-time blip in oil prices. And if you were to trend it back to what we were seeing from a long-term perspective on oil prices and production, there could be a significant amount of revenue that would be characterized as one-time revenue. I did that analysis for pre-session work. Right now, we are not seeing prices abate. As I read more and more about world supply, all of sudden you are starting to hear comments that there is not a lot of excess capacity out there to produce more oil. The next issue that enters the picture is alternative energy sources. Under the individual income tax, if we were to identify a lot of capital gains, that there is an inordinate amount of capital gains that was reported associated with some one-time event, then yes, we would try and characterize that as one-time revenue. My fear is that we will not be able to do that, not be able to have the data to isolate that for you.

JEFF MARTIN discussed the interim study assignments. There were two resolutions: HJR 43, introduced by Rep. Jim Peterson, to study the valuation of agricultural land; HJR 44, introduced by Rep. Alan Olson, the property taxation of oil and natural gas property. The staff will present study plans for the two resolutions at the next committee meeting. Mr. Martin said that it is important that the committee coordinate the Ag valuation study with the Department of Revenue and the Agriculture Advisory Committee.

REP. WAITCHIES asked for a review of the Ag Advisory Committee. **MR. MARTIN** said that he did not think that the Governor has made the appointments for that committee yet. The Department is working on a project plan.

REP. WAITCHIES asked Mr. Wilke if the Advisory Committee did a study last session and will it be the same committee, different committee, are they going to use that study, where are we going with it? **MR. WILKE** said that in the past that has amounted to recommendations from the various Ag groups to the Governor's Office.

SEN. ELLIOTT said that two Octobers ago, he was requested to come to a meeting of that committee where they approved that study. What happened to that study? **MR. WILKE** said that it became House Bill 72; a piece of legislation recommending that there be two land use types: farm land and grazing land. He thought it makes more sense to continue the use of the existing five land use types.

REP. LAKE said that seeing the amount of work that Rep. Waitchies said was accomplished last time and the report that was available, do you feel it might be to our advantage to have a copy of that report to review before the next one comes in. **MR. MARTIN** said that he would do a summary so that the Committee would have an idea of what to look for.

JEFF MARTIN discussed the Review and Analysis of Major Tax Source section of the proposed work plan.

SEN. ELLIOTT said that there are two things that he is interested in. One is the relationship of interstate corporations to smaller businesses in Montana, main street businesses, and even larger Main Street businesses. The second one is the interrelationship between S corporations and regular corporations and LLCs. **REP. LAKE** thinks that the explanation of the Montana corporate taxes may give that information. He does not believe that we want to step into micro-managing, either pulling a benefit to one particular group, trying to hold somebody else up if they cannot stay in to them. If we detailed information on the corporate tax structure, including all types, we would find that we would understand enough that the rest would not have to be gone through.

MR. MARTIN said the committee may be interested in the different types of business organizational structures and the tax issues. He also said that the committee might be interested in looking at trends in corporate tax, both at the federal and state level. At the state level would mean looking not only at Montana but other states as well. The goal would be to help the committee, as well as other people, have a better understanding of how the tax system works and at each interim look at it another system to build a good information base on Montana's tax structure.

REP. WAITCHIES said that he would rather stick with Montana, see how the C and S corporations fit together.

JEFF MARTIN discussed the work plan items related to Department of Transportation.

SEN. KITZENBERG requested an update by the September meeting regarding the ethanol issue and the fleet of the 885 cars. **JIM CURRIE**, Department of Transportation, said that some of the 885 cars have been sold as part of the rotation. He will bring the final report on design

building to the next meeting.

JEFF MARTIN discussed the item "Litigation Reports" that the Department of Transportation and the Department of Revenue periodically brief to the committee regarding litigation that each department may be involved in. REP. McALPIN asked that with items like this, would it be possible to brief the committee by e-mail and if there are questions, we could receive verbal briefing to save time on the committee's schedule. MR. MARTIN said that he would get in touch with each department to see how that might work out and find out what might be coming up.

JEFF MARTIN discussed the item "Irritants to the Committee and Staff". This is to look at issues that the committee might have that are not covered in the work plan, not necessarily policy issues but clarifying a particular provision in law.

JEFF MARTIN discussed the Committee's scheduled meetings with September 30 as the next meeting date.

Administrative Rule Review

LEE HEIMAN, Legislative Services Division, Legal Staff (**Exhibit 9**) discussed the Administrative Rules Review.

REP. LAKE asked if they will receive a 2-week notice prior to a rule going into effect. MR. HEIMAN said the proposed rules go out every two weeks. REP. LAKE asked if the proposed rules go to the legislators as well or do they have to search them out if someone comes to them regarding a rule. MR. HEIMAN said that the current rules are on the Internet. SEN. ELLIOTT asked Mr. Heiman if he could give that site to every member of the Committee and if there are members who would like a hard copy of the ARM, the Secretary of State's Office will provide them. REP. CONEHOUR asked if Mr. Heiman could expand on the polling of the objection to the rule. MR. HEIMAN said that that is to determine whether the proposed rule actually is within the Legislature's intent. A single committee cannot determine that for the whole Legislature. There is a procedure for a committee to request a polling where a statement is sent to every legislator and they are to vote whether it complies or does not comply.

REVISE AND ADOPT OF COMMITTEE WORK PLAN AND MEETING SCHEDULE

JEFF MARTIN said that it would be helpful if the committee adopted a meeting schedule for planning purposes. **REP. WAITCHIES moved to tentatively adopt the meeting schedule with the chairman being able to change the dates at his discretion, if needed. Passed unanimously.** Sen. Elliott asked the Committee members if there was any changes in the

work plan and there were none.

SUMMARY OF TAX LEGISLATION ENACTED DURING 2005 LEGISLATIVE SESSION

JEFF MARTIN said that he has been putting together a tax summary since the 1993 session as a reference document.

ADMINISTRATIVE MATTERS

JEFF MARTIN asked how the Chair wants to keep track of documents provided to members of the committee. **REP. BLACK** would like each member be responsible for their own files. **REP. WAITCHIES** would like to have copies of documents kept by the staff. **Mr. Martin** also said that, except for the first meeting, audio minutes would be used for the committee.

PUBLIC COMMENT

WILLIE DUFFIELD, Executive Director of Montana Association of Oil, Gas and Coal Company, said his organization would like the committee to do the SJR 44 study of oil and gas property. The association would like to see that settled by the Legislature and not by the court system. They are concerned that if the court decides, it will have immediate impact on the counties; whereas, if the Legislature could come up with a bill that could resolve the problem, there may be a way to deal with the impacts. **SEN. ELLIOTT** said that if we have a court decision and a legislative solution, we are powerless to do anything until the court says it. **MR. DUFFIELD** said the court hearing is scheduled for December, would it be possible for the Legislature to do something before that date? **REP. BLACK** asked who the parties are in the suit. **MR. DUFFIELD** said in that case it is Omimex and the Department of Revenue. The other will be in February and that is Encana.

JEFF MARTIN said that it may not be a constitutional issue but rather the way the Department of Revenue values property. The rule is, if it is in more than one county and connected, it is going to be classified as Class 12 property and taxed at a higher rate. If it is in a single county and depending upon ownership, it would be taxed as class 8 property at 3%. If the court upheld the Department's valuation method, the Legislature could certainly respond revising how gathering lines or flow lines are taxed, or if it goes the other way, the Legislature could respond to the court decision without worrying about constitutional issues. **MR. HEIMAN** said that the Legislature could mitigate any problems that may come from cash flow. **SEN. ELLIOTT** asked if this is similar to the trending arbitration, not relating to trending in and of itself, but to the department rule. **MR. HEIMAN** said yes, it is still within the baliwick of the Legislature.

REP. McALPIN asked if equalization was a constitutional question and if it was being

considered in the pending litigation. MR. HEIMAN didn't think so, he thinks the definition of what is centrally assessed, whether it is centrally assessed or not that would relate on its tax in the central assessment statute we did as a legislative piece.

OTHER BUSINESS

SEN. ELLIOTT said that Mr. Ken Morrison of PPL MONTANA would like to discuss their dispute with the Department of Revenue at the next meeting. **SEN. ELLIOTT** said that, with the committee's permission, he would write the letter to the congressional delegation and to Wyoming on behalf of the committee on the Beartooth Highway repair. Roundabouts will be on the next meeting's agenda. The next meeting will be September 30, 2005

ADJOURN

SEN. ELLIOTT adjourned the meeting at 3:30 p.m.

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