



Revenue and Transportation Interim Committee

59th Montana Legislature

SENATE MEMBERS

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

HOUSE MEMBERS

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

COMMITTEE STAFF

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

MINUTES

September 8, 2006

Room 137, State Capitol
Helena, Montana

Please note: These minutes provide abbreviated information about committee discussion, public testimony, action taken, and other activities. The minutes are accompanied by an audio recording. For each action listed, the minutes indicate the approximate amount of time in hours, minutes, and seconds that has elapsed since the start of the meeting. This time may be used to locate the activity on the audio recording.

An electronic copy of these minutes and the audio recording may be accessed from the Legislative Branch home page at <http://leg.mt.gov>. On the left-side column of the home page, select *Committees*, then *Interim*, and then the appropriate committee.

To view the minutes, locate the meeting date and click on minutes. To hear the audio recording, click on the Real Player icon. Note: You must have Real Player to listen to the audio recording.

COMMITTEE MEMBERS PRESENT

SEN. JIM ELLIOTT, Chair
REP. KARL WAITSCHIES, Vice Chair

SEN. JERRY BLACK
SEN. KIM GILLAN
SEN. SAM KITZENBERG

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

COMMITTEE MEMBERS EXCUSED

SEN. GREGORY BARKUS
SEN. KEN TOOLE

STAFF PRESENT

JEFF MARTIN, Lead Staff
LEE HEIMAN, Staff Attorney

DAWN FIELD, Secretary

AGENDA & VISITORS' LIST

Agenda, Attachment #1.
Visitors' list, Attachment #2.

COMMITTEE ACTION

The Revenue and Transportation Interim Committee:

- approved the June 29 & 30, 2006, minutes, as written;
- approved the Department of Transportation legislative proposals;
- approved the Department of Revenue legislative proposals; and
- rejected a motion asking the Department of Revenue to delay implementing rules on little cigars.

PART ONE - TAPE 1 - SIDE A

CALL TO ORDER AND ROLL CALL

00:00:01 SEN. ELLIOTT called the meeting to order at 8:01 a.m. The secretary took roll call, SEN. BARKUS and SEN. TOOLE were excused. SEN. GILLAN **moved** to approve the June 29 and 30, 2006, minutes. The **motion** passed on a unanimous voice vote.

FY 2006 GENERAL FUND REPORT

00:01:27 **Terry Johnson, Principal Fiscal Analyst, Legislative Fiscal Division (LFD)**, presented a PowerPoint summary of the FY 2006 actual revenue collection and the 2007 biennium projected general fund status (EXHIBIT #1). He noted that copies of the full report were also provided to Committee members (EXHIBIT #2). Mr. Johnson discussed the:

00:04:22 general fund ending balance for FY2006;

00:08:17 general fund balance components: revenue, disbursements, and balance adjustments;

00:29:37 FY 2006 general fund balance change summary; and

00:30:50 general fund 2007 biennium outlook.

00:37:22 Mr. Johnson said that the state has never had an ending fund balance of over \$400 million. He cautioned the Committee that a detailed final analysis has yet to be completed and that supplementals would also likely have an impact on the final numbers.

TAPE 1 - SIDE B

00:39:24 REP. LAKE asked if higher corporate tax collections are fairly common in the region and nation. Mr. Johnson said that Montana's corporate tax collections are doing very well, which is not unique either regionally or nationally.

00:41:41 REP. LAKE asked how much of the \$72 million supplemental is designated for wildfire costs. Mr. Johnson said that LFD, based on information provided by the Department of Natural Resources and Conservation (DNRC), has estimated that wildfire costs will be approximately \$30 million. He said that even though it may

not be as big a fire year as 2004, Montana's share will be higher because the federal reimbursements will be smaller.

- 00:43:50 REP. LAKE said that he thought wildfire costs were already approaching \$40 million and climbing fast. Mr. Johnson agreed that costs could go much higher and said that it is very likely that the \$72 million supplemental will be increased.
- 00:44:33 REP. WAITSCHIES asked why insurance premium taxes are down by \$2.8 million. Mr. Johnson said that there are two possibilities: premiums are somewhat constant or that there is not as much insurance being written. He said that LFD is hoping to get more detailed information to see why this is happening in this category.
- 00:47:11 REP. WAITSCHIES asked who is responsible for auditing the insurance tax. Mr. Johnson said that the State Auditor is responsible.
- 00:47:29 SEN. BLACK asked how much greater percentage of wildfire costs the State will have to pay in 2006 than in 2004. Mr. Johnson said that he did not have that information but would get it. SEN. BLACK asked if it would be a significant difference. Mr. Johnson said it will be very significant.
- 00:48:08 REP. LAKE asked if federal reimbursements are based on how much federal land has burned in the state. Mr. Johnson said that is correct and that it also depends on whether a Federal Emergency Management Agency (FEMA) determines that a fire meets its criteria for reimbursement. He said that he would ask Barbara Smith, Legislative Fiscal Analyst, to prepare a report on how federal funding for wildfire costs is formulated.
- 00:49:52 SEN. BLACK asked if the estimate includes the Derby Fire. Mr. Johnson said that some of the Derby Fire expenses are included but not all.

ACCESS TO TAX AND REVENUE INFORMATION

Update on Economic Affairs Interim Committee SJR 38 Study on Identity Theft

Pat Murdo, Research Analyst, Legislative Services Division (LSD), referred members to LC7800 (EXHIBIT #3) and an accompanying explanation sheet (EXHIBIT #4) containing the history of the SJR 38 study on identity theft, conducted by the Economic Affairs Interim Committee (EAIC). Ms. Murdo said that she was working with other governmental officials and agencies on the use of social security numbers. She worked with Ann Brodsky, Legal Counsel, Governor's Office to develop LC7800. She said LC7800 would allow each state agency to develop its own policy on how to handle social security numbers. Ms. Murdo gave a general overview of the proposed bill draft, highlighting several of the more significant requirements of the bill. She said that RTIC still has the opportunity for input and noted out that there also is proposed federal legislation dealing with the use of social security numbers.

Bill Drafts to Revise and Clarify Laws on Access to Tax Information

- 00:57:22 **Lee Heiman, Staff Attorney, LSD**, said that there are two proposed bill drafts to review: LC0043 - (EXHIBIT #5), drafted at the request of the Legislative Finance

Committee and RTIC; and LC0043, as revised by the Department of Revenue (DOR) (EXHIBIT #6). He said the differences between the two proposed bill drafts include:

- the amount of disclosure information on a return that can be provided to fiscal analysts; and
- who and how information can requested from DOR.

Mr. Heiman said that each proposal would apply to the Office of Budget and Program Planning (OBPP). He said that OBPP would like the language to be very clear that whatever information is provided to LFD is also provided to OBPP.

01:02:36

Dan Bucks, Director, DOR, said that DOR is very supportive of making sure that the Legislature has the information that it needs for policy making but that DOR also must make certain that the information is balanced by the right of privacy for individuals and conformity to federal restrictions on how information is handled. He said that there are serious federal sanctions for violations and that DOR cannot risk losing access to the federal information.

Director Bucks, referring to a meeting the previous day with SEN. ELLIOTT, REP. WAITSCHIES, LFD, and committee staff to resolve the issues remaining between DOR and LFD, said that the meeting was very productive and that in his opinion, a major breakthrough was reached because LFD came to understand that some of the most important revenue estimating issues have nothing to do with the current law or any proposed changes in the law because this information is not collected in great enough detail by DOR to make a detailed analysis. Director Bucks stressed that there is no legal barrier to the sharing of that information and said that the barrier has been the lack of staff and processing equipment needed to capture the information from the federal schedules.

01:07:26

Regarding the proposed bill drafts, Director Bucks said that it was his understanding that it had been agreed that the DOR version (EXHIBIT #6) was acceptable, which would change current law in two respects: 1.) To add a state account record identifier to the individual income tax information in order to track a taxpayer from year to year. This would still provide protection for personal information, such as name, address, and social security number and would meet federal privacy requirements. 2.) To clarify that corporate tax data can include the identifier information for publically traded corporations but not for privately held corporations, S corporations, or small businesses. Director Bucks said that the DOR version (EXHIBIT #6) is a prudent approach and addressed the serious considerations that had to be dealt with.

Director Bucks said his DOR legal counsel has advised him that there are additional federal issues that need to be dealt with. He said that he also received a notice from the Internal Revenue Service (IRS) that there will be restrictions placed on the use of certain federal information while the federal government reviews how states use this information. He said that the IRS does not recognize revenue estimation as a tax administrative purpose, so information coming directly from the federal government to DOR can't be shared with LFD or OBPP. The IRS will render an advisory opinion of proposed state legislation to see if it meets federal standards. Additionally, the federal privacy act says that social

security numbers cannot be shared unless it is for tax administrative purposes. Since the IRS has declared that revenue estimating is not a tax administration purpose, there is a serious question regarding social security numbers for this purpose. Director Bucks said federal law is complicated and substantially affects the work being done. He suggested that any proposed legislation be submitted to the IRS for an advisory opinion.

Director Bucks said that Mr. Johnson had indicated at the previous day's meeting that in some instances it is helpful to LFD to know, for a small number of records, the business activity associated with that return in order to make a judgement on if it is a rising or falling industry. It is also helpful to LFD to have additional tax schedule information but that information can be shared only if it is not provided by the IRS. Director Bucks said that the taxpayer can share that information, providing that confidentiality concerns are met. He suggested that the Memorandum of Understanding (MOU) **TAPE 2 - SIDE A** with LFD be modified to allow some of this information, on a limited basis and within DOR judgment, to be provided to LFD and OBPP. He said that because this is a technical issue, it would best be handled through the MOU and not legislatively. Director Bucks also noted that DOR has expanded its state tax return form in order to gather more information from the taxpayer.

Director Bucks said that Section 4 (EXHIBIT #6) is intended to make sure that the state complies with federal regulations and to establish a clear procedure for access to information. DOR wants that procedure to be followed by all state agencies and officials.

Director Bucks said that the Office of Budget and Program Planning would like the bill draft amended to require that the language also apply to OBPP.

01:23:11

REP. LAKE, referring to the penalty language in Section 4, said that if procedures are already in place to protect the information, this language is not needed. Director Bucks said that the language applies to agencies with which DOR has a written MOU and lays out the proper procedure for requesting information. He said that because this is very important personal and financial information, serious measures are required to ensure adequate protection. Director Bucks gave the example of how a state employee is directed to use a state computer, saying that there are penalties for abuse and that it is unlawful to circumvent the controls on the computer to guarantee the computer is used only for state business. He said that Section 4 is meant to accomplish the same purpose - that attempts to circumvent the proper process to access very personal and important information will not be tolerated.

SEN. ELLIOTT said that while no one disagrees with the intent of the language in Section 4, he would like it rewritten.

01:28:15

REP. LAKE said that there needs to be clarification of what information can and cannot be shared. Director Bucks said that it frequently hinges on the source of the information. With the exception of a social security number, information from an individual may be shared with LFD and OBPP, provided that the information is

kept confidential within those agencies and is covered by a state confidentiality statute. However, if a tax payer is audited by the IRS or if the IRS sends information about a particular taxpayer, DOR cannot share this information. Social security numbers are not allowed to be released to anyone except for tax administrative purposes and even DOR cannot use them within the department for any other purpose. Director Bucks said that he had received an email from the IRS just the day before regarding new restrictions on the use of social security numbers for liquor licenses. He said that while he does not always agree with the federal rulings, he has to follow the requirements of the rulings.

01:32:11 SEN. ELLIOTT said that a meeting had taken place on Thursday, September 7, with Director Bucks, Terry Johnson, Rep. Waitschies, Sen. Elliott, and Mr. Martin. He said that it is recognized that there is a great need for in depth analysis of tax data. One of the problems is that some of the data is not captured by DOR because of the costs of doing so. DOR has indicated that if the information was captured, it would be willing to share the information with LFD and OBPP, so long as no identifying information was released with the records. SEN. ELLIOTT suggested that if those documents were scanned into a computer and put into a data bank, the identifiers could be struck from the documents and the information disseminated to LFD and OBPP. SEN. ELLIOTT said that REP. WAITSCHIES and he have discussed the possibility of enabling DOR to purchase the necessary equipment to scan the information. He said that it would be an expensive project but would greatly improve the flow of information and would aid RTIC, the Legislative Finance Committee (LFC), OBPP, and DOR in their work. He proposed that DOR present information to RTIC on the costs associated with enabling the department to do this and an estimation of the cost savings also.

01:35:48 Mr. Martin suggested that Mr. Johnson and/or Mr. Schenck respond to Director Bucks' statements. He said that LFC should be informed of any RTIC decision so that it can decide if it wants to remain a requestor of proposed legislation and noted that the bill draft that LFC reviewed contained fuller disclosure measures than the version discussed by Director Bucks (EXHIBIT #6).

01:37:38 SEN. ELLIOTT said that the choices are as follows: does RTIC want to allow LFD and OBPP access to the raw data and if so, does RTIC want to grant access to the individual name and identifying information.

Mr. Martin said that Director Bucks had suggested getting an advisory opinion on the proposed legislation from the IRS. He asked if both proposals could be reviewed in order to get a better sense of what the federal position would be. Director Bucks said that requesting federal review would be a prudent move and that he would submit both proposals, although he couldn't guarantee a timely response. He noted that the IRS plans to review Montana's procedures for protecting confidential tax information in February 2007, and is an indication of the level of concern this issue is generating.

01:39:43 SEN. ELLIOTT asked Mr. Johnson to respond to Director Bucks' comments. Mr. Johnson said that because some of Director Bucks' statements contained new information, he would like to confer with legal counsel before commenting. Mr.

Johnson said that it is his opinion that this issue is not about LFD or OBPP so much as the power and authority of the Legislative Branch. He discussed three points:

- It is the responsibility of the Legislative Branch to establish policy. Revenue estimating is only one function of LFD. The LFD is also called upon to perform tax policy analysis and other work throughout the interim and legislative session. The Legislative Fiscal Division is very aware of privacy requirements and does not provide, for example, information to RTIC due to confidentiality requirements.
- The Legislature is the policy "arm" of state government and as staff to legislators, LFD tries to provide whatever information it can, within the constraints of the privacy requirements. The staff's concern is information constraints are limiting the ability of the Legislature to establish sound policy. Director Bucks has discussed some alternatives for providing more detailed information but the alternatives would have to be carefully examined before deciding whether or not they would work. SEN. ELLIOTT and Director Bucks have also suggested that additional information could be captured from tax returns, so long as identifying information is blocked out. There is no doubt that the additional information would help the legislative process immensely in many cases. However, there are times when LFD needs to know what type of activity an individual taxpayer is engaged in. Without that information, the accuracy of the information LFD provides legislators is affected. This Committee and the Legislature have to decide what information it needs to establish sound tax policy. As staff, LFD will respect that decision and operate within the guidelines of that decision.
- The message that seems to be coming from DOR is that DOR is very concerned that LFD staff will not be able to maintain confidentiality of the information. The Legislative Fiscal Division has established sound policies to protect confidential information, including hiring a national security company to assist in writing the policy. This issue is taken very seriously by LFD.

01:47:09 SEN. ELLIOTT asked OBPP if it wished to respond to any comments made by Director Bucks. The Budget Office declined to comment.

01:47:38 SEN. ELLIOTT asked Clayton Schenck if he wished to comment. Mr. Schenck said that he was not present at the meeting on Thursday so could not comment on that but did concur with Mr. Johnson's statement that confidentiality is of the utmost concern to LFD staff. He agreed that the Legislature needs to decide on what level of information it needs and how accurate the data must be.

01:48:38 Mr. Martin said that DOR has this issue listed as part of its legislative proposals. He said that one option would be that DOR introduce its version (EXHIBIT #6) and that RTIC introduce its proposed bill draft also (EXHIBIT #5), allowing both bills to be considered by the Legislature. He said that additional information may be available from the IRS at that point also. SEN. ELLIOTT said that he hoped to achieve a compromise in order to avoid a fight in the Legislature.

- 01:50:09 REP. LAKE said that the Legislature has the responsibility to make the revenue estimates as accurate as possible and if it is not able to do so because of missing information, the Legislature is not providing good service to the citizens of Montana. He said that it is his opinion that there should be only one bill introduced in the Legislature because it is not in the best interest of the citizens to go in two different directions.
- 01:53:00 REP. COHENOUR said that that this issue came to the forefront over the last two sessions because RTIC came to the realization that it was not getting the information it needed to create accurate revenue estimates and to make wise decisions. This is not a matter of RTIC trying to force DOR to do something but rather legislators trying to fulfill their responsibility to the taxpayers of Montana to craft a fair tax policy. Legislative staff are telling this Committee that they don't have enough information to give this committee what it is asking for. RTIC wants its staff to have that information, even if the information cannot be made available to this Committee. That information must be available to staff in order to help RTIC craft tax policy. REP. COHENOUR urged DOR to rewrite the problematic language in Section 4. She said that she supported moving both proposed bill drafts forward, that both should be submitted to the IRS for review with the request for an expedited opinion. She recommended that if LC0043 - LSD version (EXHIBIT #5) - meets IRS approval, the Committee should support that bill draft.
- 01:55:19 REP. WAITSCHIES thanked LFD and DOR for working together on this issue. He said that he personally supported more information and urged them to continue working together. He agreed that the right to privacy is very important and said that LC0043 - LSD version (EXHIBIT #5) appears to provide sufficient protection.
- 01:56:13 SEN. ELLIOTT said that a potential avenue for compromise would be to furnish the raw data to LFD and OBPP with all the personal information redacted and that the tax identifier number assigned by DOR be used in its place. He said that this would allow LFD and OBPP to track individual information. Mr. Johnson said that he was concerned about the degree of expectation and explained that because none of the supporting schedules are captured at this point, much of the needed information will not be available in the 2007 session. Another concern is if an accounting identifier is available on previous tax years' returns. If not, only future information could be tracked and no information from past years will be available. Mr. Johnson said that he did not want the Legislature to have a high expectation for information and find out that it was not available.

TAPE 2 SIDE B

02:02:35

- 01:58:54 Director Bucks agreed with Mr. Johnson about the supporting schedules not being captured. He said that while it is a matter of expense, much of the information would be sharable under state law. He said that he did not think there was much difference between the two proposed bill drafts. He said that DOR is eager to make the process work and does not want a fight.

- 02:00:39 SEN. BLACK asked if a tax identifier number has been used in prior tax years. Director Bucks said that his assumption is that previous tax year identifier information is available but that since there was a recent conversion to a new system, he would check to be sure.
- 02:01:48 SEN. BLACK said that the offense of "divulging information knowingly and purposely" is a serious crime with the potential for terrible consequences for the individual or business. He said that in his opinion, the penalties in the proposed bill draft are not commensurate with the crime and should be more severe. REP. COHENOUR said that this type of offense would likely allow the damaged party to file a civil suit as well.
- 02:03:45 SEN. ELLIOTT suggested that LFD and DOR continue to work on a compromise. He asked DOR to study the feasibility and expense of automating the data capture process. In the event that LFD and DOR cannot come to an agreement on one bill draft, then the Committee can make a decision at its November meeting on which bill it wishes to introduce. REP. COHENOUR asked that each proposed bill draft be submitted to the IRS for review. REP. LAKE asked that it be on the record that OBPP be included in the process also. SEN. ELLIOTT agreed.
- 02:21:54 SEN. ELLIOTT asked for public comment on the accessibility to tax information discussion. None was given.

UPDATE ON DEFINITION AND TAXATION OF LITTLE CIGARS

- 02:23:13 **Kelly O'Sullivan, Assistant Attorney General, Department of Justice (DOJ)**, reported that she has worked closely with Attorneys General from other states through the National Association of Attorneys General to deal with various tobacco enforcement issues. Ms. O'Sullivan said that she was appointed as Chair of the Little Cigar working group, which drafted a petition addressing the issue of little cigars. The petition was filed in May 2006, by 39 Attorneys General and one territory. Ms. O'Sullivan said that there are products that are little cigars that are legitimate products. The product addressed by the working group are little cigars that are designed like and look like cigarettes. Ms. O'Sullivan discussed a slide presentation on little cigars (EXHIBIT #7):
- United States cigarette/little cigar consumption from 1999-2005;
 - the number of little cigars sold in Montana from 2004-2006;
 - taxes on cigarettes versus cigars; and
 - quotes from several industry experts and from health care experts.
- Ms. O'Sullivan said that she would provide a copy of the petition to the Committee.
- 02:37:50 REP. LAKE asked if other states have looked at the process of identifying the differences between cigarettes and little cigars. Ms. O'Sullivan said yes and that some states are already taxing little cigars as cigarettes. REP. LAKE asked if those states have a definition in place that describes the differences between the two products. Ms. O'Sullivan said that each state has its own definition and that the definitions vary tremendously.

- 02:40:22 SEN. ELLIOTT said that little cigars first appeared in 1973 and asked what brand they were sold under. Ms. O'Sullivan said that they were sold as Winchesters. SEN. ELLIOTT asked what they looked like. Ms. O'Sullivan displayed a box for the committee to view. SEN. ELLIOTT said that the pack appeared to be a cigarette box and asked what the sales figures were for the product. Ms. O'Sullivan said that Winchesters sold well because they were being advertised on television and were sold in packs of 20.
- 02:41:29 REP. MCALPIN asked Ms. O'Sullivan to review how I-149 raised Montana cigar and cigarette taxes. Ms. O'Sullivan said that I-149 raised cigarette taxes from \$.70 per pack to \$1.70 per pack and taxes on little cigars increased from approximately 25% of the wholesale value to 50% of the wholesale value.
- 02:43:26 REP. LAKE asked how are little cigars are distributed. Ms. O'Sullivan said that little cigars are sold to retailers through a licensed wholesaler and that retailers also may also purchase directly from a manufacturer.
- 02:45:00 REP. WAITSCHIES asked how the tax on cigars compares to the tax on cigarettes. Ms. O'Sullivan said that the amount of tax paid on a cigar is 50% of its wholesale value and that cigarettes have a flat tax of \$1.70 per pack.
- 02:47:45 SEN. BLACK asked Mark Staples to comment. **Mark Staples, Montana Tavern Association**, said that Ms. O'Sullivan's explanation of how cigars are taxed was correct and said that the tax paid on a fine cigar would be significantly more than on a cigarette. SEN. ELLIOTT asked what the wholesale price is of a pack of cigarettes. Mr. Staples said that the wholesale price of cigarettes depends on the brand and quality of the product.
- 02:51:43 SEN. BLACK asked Mr. Staples to comment on retailers selling to underage smokers. Mr. Staples said that the premise driving this rule proposal is fallacious and is not empirically documented. The results of the Montana Youth Access to Tobacco surveys show that there is a 92% compliance rate (EXHIBIT #8). The premise that these or any other tobacco products are being sold to minors is simply fallacious.

TAPE 3 - SIDE A

- 02:53:44 Mr. Heiman discussed a memo regarding the DOR proposed rule changes (EXHIBIT #9). He said that if the Committee wished to make a statement regarding the proposed rule on little cigars, it would have to do so at this meeting because the public comment period ends September 8, 2006. He said that in his opinion, DOR has the legal authority to adopt the rules and has followed the statutes in doing so. He said that proposed Rules II - IV (EXHIBIT #10) pertain to the little cigar issue and that the remaining proposed rules are mostly housekeeping in nature relating to other tobacco laws. Mr. Heiman read 16-11-102(2)(a), MCA -- definition of cigarettes -- aloud to the Committee and discussed the changes made in the definition.

02:57:24 REP. COHENOUR asked Mr. Heiman to clarify that the proposed rules are intended to implement action taken by the 2005 Legislature and that the only significant change is the definition of what a cigarette is. Mr. Heiman said that there are a lot of proposed housekeeping rules, but the main controversy involves the definitions of cigarettes and if little cigars fall under this definition. If they are captured under this definition, they will have to be packaged, taxed, and sold as cigarettes.

02:59:13 REP. MCALPIN asked Ms. O'Sullivan if there is any evidence that little cigars are being sold to children. Ms. O'Sullivan said that she does not have demographic information on who is buying them, just the number of little cigars being sold, versus cigarettes. REP. MCALPIN asked if anyone present in the audience had that information. No one responded.

Public Comment

03:01:35 Mark Staples, Montana Tavern Association, said that the proposed rules will change a product (little cigars) that has been in existence for over 50 years by requiring that it be taxed, labeled, and packaged differently; and that the changes will be made not by public policy debate but by rule. There is no statistical evidence to prove that little cigars are being sold to children, in fact, Montana retailer's compliance rate is among the highest in the nation. The target rate for compliance is 80% and Montana's rate is at nearly 93%.

Mr. Staples said that the legislation cited by Mr. Heiman, in the strictest interpretation of the law, could make the argument that what should be done by legislation may be done by rule, but it is based on the definition of cigarettes in the legislation. This legislation (House Bill 687) was proposed by the retailers and wholesalers to deal with smuggling, Internet sales, cross-border sales and several other related issues. It had nothing to do with little cigars, yet in the definition section, changes were made to say that a product is a cigarette if it is likely to be sold to or purchased by a consumer as a cigarette. The question is not whether the policy arguments are correct, but if a bill that was introduced to address other tobacco issues be used to address little cigars, which wasn't even a concern of the original legislation. Mr. Staples said that the HB 687 came very close to being killed on several occasions and that it was the industry that rallied support for it. He said that it may be legal but is unconscionable to now use the bill to "beat the very retailers and wholesaler over the head who saved the bill...". Mr. Staples said that this is an issue that should be brought before the full Legislature and not decided by rule.

03:10:46 **Ronna Alexander, Convenience Store Association**, said that she polled her membership when the proposed rules were published to attempt to determine if there has been an increase in the sales of little cigars in the last few years. Some members reported an increase and others did not. Ms. Alexander said that a large distributor reported that the sale of cigars and cigar products account for about 8% of its total tobacco sales in Montana and that little cigars are only .022% of the 8%. Ms. Alexander said that her association does not object to reclassifying some of the products but that it is concerned about how it is being done. The association believes that this issue should be addressed through

legislation and not by rule because the end result is a tax increase and the action will set a precedent. Ms. Alexander asked that the Committee request DOR to segregate this issue from the other proposed rules and let the 2007 Legislature deal with the issue.

03:14:30 **Dr. Robert Shepard, Helena**, said that his testimony is from a consumer usage point of view: There is no question that the consumer pays more for a single cigar but the consumer is most concerned with cost and the price point at which his willingness to buy is affected. Single stick sales are a big issue, particularly where adolescents are concerned. Adolescents are very price sensitive and if the price is raised by even 10%, sales to adolescents will decrease.

Dr. Shepard said that Montana's 93% compliance rate is great but means that 7% of stores are selling to minors. It doesn't take long for a minor to find out where these stores are. He said that it takes only one cigarette a day for six weeks to become addicted to tobacco, which is a strong argument for closing this loophole for the protection of Montana's youth.

03:19:06 **Cliff Christian, American Heart Association and American Lung Association**, said that availability is a big issue and that it is very easy for adolescents to find someone to purchase tobacco products for them. There is also a considerable amount of theft occurring. He said that huge changes in packaging, the addition of flavoring and scents, and marketing strategies make little cigars very attractive to teenagers. The Center for Disease Control has estimated that approximately 22% of Montana's children are smoking.

Mr. Christian said that if the intent of HB 687 was to have it be exclusively for dealing with the issues discussed by Mr. Staples, he should have made certain that the bill included those restrictions. The legislation and the proposed rules have been reviewed by experts and opinion is that DOR has a strong position.

Mr. Christian distributed several documents relating to little cigars:

- EXHIBIT #11 -- a letter from G. Steven Brown, attorney for the American Cancer Society and the American Heart Association stating that in his legal opinion, DOR has the authority to adopt the proposed rules;
- EXHIBIT #12 -- a news release from the American Cancer Society, the American Heart Association, and the American Lung Association in support of the proposed DOR rules;
- EXHIBIT #13 -- Newsday.com editorial on the regulation of tobacco products; and
- EXHIBIT #14 -- a memorandum of support of prohibiting the sales of flavored cigarettes.

03:27:23 Director Bucks said that DOR will take into account all of the comments received and noted that the several legal opinions obtained by DOR all state that DOR is within its authority to adopt and implement the proposed rules. Director Bucks distributed copies of 16-11-101, MCA, (Tax on Cigarettes - EXHIBIT #15) 16-11-307, MCA, (EXHIBIT #16), and 16-11-308, MCA, (EXHIBIT #17). He noted that EXHIBITS #16 and #17 relate to the Youth Access to Tobacco Products Control Act. Director Bucks said that DOR does not view this issue so much a revenue

issue as it does a youth access issue. The definition of a cigarette changed in the 2005 session and is what necessitated the proposed changes.

Director Bucks said that it is the responsibility of DOR to reclassify the product for tax and regulatory purposes. It is not the job of the industry to define whether or not this product is a cigarette. In response to Mr. Staples' comments regarding the intent of HB 687, Director Bucks quoted Rep. Scott Mendenhall's statements on Feb. 16, 2005, and on April 1, 2005, as sponsor of the bill. He said that it is clear that Rep. Mendenhall's statements indicate that the intent of the legislation was to do more that address Internet sales and smuggling, but also to strengthen laws preventing youth access to tobacco.

TAPE 3 - SIDE B

- 03:36:22 REP. MORGAN said that the next legislative session is very close and asked why this issue couldn't not have waited until then. Director Bucks said that this issue came to the attention of DOR earlier in the year and that rules were first noticed in July. He said that as Director, he thought it should be dealt with by DOR.
- 03:38:10 REP. MORGAN agreed that it is an issue that needs to be addressed but said that, considering that the next legislative session is so close, she would rather have the Legislature deal with it.
- 03:39:10 REP. LAKE agreed with REP. MORGAN that this issue should be dealt with legislatively. He said, in reading 16-11-102, MCA, that the statutory definition of cigarettes is fairly strong. He said that this is a complex problem and that it may take more time to reach a thorough and well-thought out solution. He asked if DOR should hold off on a final decision and have DOJ look at the definition, in order to avoid a legal challenge. He said that other states are struggling with this same issue and that researching how their solutions are working may help Montana.
- 03:41:05 REP. MCALPIN said that the hospitality and convenience store associations are powerful lobbyists and have given no indication that there would be support for a change in the legislation. He asked Dr. Shepard if he could provide an estimate of how many youth might start smoking if no action is taken. Dr. Shepard said that he did not have Montana's youth initiation statistic available and that even if he did, he could not give an indication of how many youth started because of little cigars. He said that 90% of people who start smoking start before the age of 18; and that 50% of people who start smoking start before the age of 13. REP. MCALPIN asked if it would be safe to say that there will be a number of youth who would start smoking and not quit until death if no action is taken. Dr. Shepard said that that would be an accurate statement.
- 03:43:00 REP. COHENOUR commented that as a mother of a 14-year old daughter with a friend who smokes, she knows how easy it is for teenagers to obtain tobacco. She said that this issue is about children and was never intended to be an attack on the convenience and hospitality industries. She said that it is obvious to her

that a product that contains sweeteners, flavorings, and is packaged to look like markers and lip gloss, is intended to attract children. She said that on behalf of the children and their health, everything that can be done to prevent youth from smoking must be done. REP. COHENOUR said that she believes that DOR has authority to promulgate the rules and has gained several legal opinions to support this authority, and that RTIC should support DOR in its efforts. She said that she would like the Committee to send a letter of support to DOR.

- 03:45:06 REP. WAITSCHIES said that in his opinion, DOR is being allowed to set policy and that policy decisions rightfully rest with the Legislature. He said that he would rather wait until the legislative session to introduce a bill, that he would support the legislation, and that he is confident that the bill would pass.
- 03:46:10 SEN. ELLIOTT said that there are several ways to cut tobacco and that the burley cut is used for cigarettes almost exclusively. SEN. ELLIOTT cut open several small cigars and a Camel cigarette and pointed out that the cut of the tobaccos in all of the examples was the burley cut. He said that the reason he wanted to bring this to the attention of the committee is because it passes the "duck test". SEN. ELLIOTT then read aloud 16-11-103, MCA. He said that this statute, as approved by the Legislature, gives DOR the authority to take action.
- 03:52:47 SEN. ELLIOTT said that RTIC has two options: to do nothing or to vote to affirm that DOR has the authority to implement the proposed rules. REP. MORGAN said that rather than voting on whether DOR has authority, she believes that a recommendation would suffice and would give more time to consider this. SEN. ELLIOTT said that he would not object but said that the law, as interpreted by the Attorney General and LSD attorney Lee Heiman, gives DOR the power to do this.
- 03:55:53 REP. LAKE asked if a statement from RTIC would have any influence on the enactment of the proposed rule. Director Bucks said that DOR is mindful of all comments it receives. He said that he wanted to make it clear that this is a health and safety issue and that this issue is the reason that DOR addressed this. The problem was brought to DOR's attention and it was determined that action was needed and within the authority of the department.
- 03:57:44 REP. LAKE **moved** to send a letter of support to DOR stating that RTIC recognizes DOR's authority to act on this issue but that RTIC also recognizes that this is a complicated issue, that it may be further addressed through legislative action, and that RTIC respectfully requests that the Director withhold final action on the proposed rules until the 2007 Legislature is in session.
- SEN. KITZENBERG stated for the record that he is currently employed by the Department of Revenue and that the question of whether or not he should vote on these measures was brought up to him by another Committee member. He stated that he had consulted with Greg Petesch, Code Commissioner, LSD, and SEN. ELLIOTT, Committee Chair. He asked SEN. ELLIOTT to inform the Committee about the consultation. SEN. ELLIOTT said that under rules of the Legislature and the State of Montana, anyone who has a conflict of interest must disclose that conflict of interest. Under House Rules, that person may recuse

from voting but under Senate Rules, the person has to vote. He said that he did not believe there is a conflict of interest, but that if SEN. KITZENBERG thinks that he has a conflict of interest, he still must vote on this issue.

04:00:17 REP. COHENOUR said that she would support the motion so far as DOR's rulemaking authority is concerned but would not support the remaining language. She said that a law has been approved by the Legislature giving DOR the authority to promulgate rules and that legislators cannot interfere with this authority.

04:01:13 REP. LAKE clarified that his motion was not to keep DOR from doing anything, it was a request that the department refrain from enacting the rules. The **motion failed** on roll call vote 5-7, with SEN. GILLAN, SEN. KITZENBERG, SEN. TOOLE (by proxy - SEN. ELLIOTT), REP. COHENOUR, REP. HINER, REP. MCALPIN, and SEN. ELLIOTT voting no. (Attachment #4)

UPDATE ON OIL PRICE DIFFERENTIAL TASK FORCE

04:03:25 **Greg Jergeson, Commissioner, Public Service Commission**, said that he was reporting to RTIC as a member of the Interstate Oil & Gas Compact Commission (IOGCC) Price Differential Task Force. He provided copies of his testimony (EXHIBIT #18) and a printout of the IOGCC member web page (EXHIBIT #19). He said that he has been very disappointed in the lack of activity and that very little has been accomplished to date.

PART TWO -- AFTERNOON

UPDATE OF FINDINGS AND RECOMMENDATIONS OF FISCAL NOTE WORKING GROUP

00:00:01 **Jon Moe, Fiscal Analyst, LFD**, briefly explained the purpose and makeup of the working group. Mr. Moe presented a summary sheet of options considered by the working group (EXHIBIT #20) and the final report to be presented to the Legislative Council and the Legislative Fiscal Committee (EXHIBIT #21). **TAPE 4 - SIDE A** He said that there were many options considered and a wide range of ideas and suggestions. The Legislative Council approved 18 of the 25 proposals presented by the working group. Mr. Moe discussed the summary sheet.

DEPARTMENT OF TRANSPORTATION

00:08:42 **Jim Currie, Montana Department of Transportation (MDT)**, discussed dyed fuel inspections for fiscal years 2005 and 2006 (EXHIBIT #22).

00:12:21 SEN. GILLAN asked if there is a particular group that presents enforcement problems. Mr. Currie said that diesel pickup trucks are difficult to deal with because MDT doesn't have the same authority for them as it does for commercial trucks. SEN. GILLAN said a constituent has approached her about private contractors not using dyed fuels correctly. She asked if MDT has been approached with similar concerns. Mr. Currie said that MDT has discussed this issue with private contractors and that the agreement is that they will burn taxed fuel on public projects and are eligible for the fuel tax refund. There can be issues in certain situations, such a contractor having to move between several

projects that may be publically and privately funded projects. He said that taxed fuel is used for all state funded projects.

- 00:15:07 SEN. GILLAN asked it that is standard for local government as well. Mr. Currie said that he didn't know.
- 00:15:26 **Bob Turner, MDT**, said that in the 2005 session, SB123 created a special fuel users permit for people who work on contracts with city, county, states, and federal governments and requires that clear fuel be used. Mr. Turner explained the provisions of SB 123.
- 00:16:30 REP. WAITSCHIES, referring to EXHIBIT #22, asked how an individual can have a sample not in violation but still have to pay a fuel penalty. Mr. Currie explained that the \$800 in fines were written but not collected because after testing, the samples were found to be in compliance.
- 00:17:14 REP. LAKE asked for a comparison of costs to MDT for enforcement of dyed fuels versus the costs of processing refunds. Mr. Currie said that the cost is not great for commercial vehicles because they are already being stopped for safety checks. Pickup trucks are very difficult to track and fine. It would likely require monitoring of vehicles at the pump to determine what type of fuel is being purchased.
- 00:18:36 REP. LAKE asked if would be more cost effective to simply issue refunds to agricultural or commercial use. Mr. Currie said that the personnel and resources could be set up to process refunds more quickly but that MDT has been told that the cash flow issue is a big obstacle to businesses and individual.

COMMITTEE REVIEW OF AGENCY LEGISLATIVE PROPOSALS

- 00:20:41 Mr. Martin reminded the Committee that the review of agency legislation by interim committees was established in 1999. He explained that the purpose is to facilitate the drafting of agency proposals for introduction before the start of the legislative session. He emphasized that if a committee approves a proposed bill for drafting, that approval does not indicate a committee's position on the proposed legislation, it simply allows the proposal to proceed through the drafting process.
- 00:22:52 **Tim Reardon, Chief Counsel, MDT**, provided an overview of nine pieces of proposed legislation for consideration by RTIC (EXHIBIT #22).
- 00:36:50 REP. MCALPIN asked, regarding the third aeronautics bill, for a list of state-owned airports. Mr. Reardon said that he would provide a list to REP. MCALPIN. REP. MCALPIN asked, regarding the drug and alcohol impairment bill, if MDT has considered including sleep deprivation and prescription medications in that category. Mr. Reardon said that prescription medications would be likely be covered by the drug requirements and that he would check into sleep

deprivation. SEN. ELLIOTT supported REP. MCALPIN's request, saying that he has observed sleepy drivers swerving on roadways.

- 00:38:24 SEN. BLACK asked if the 15% tax reduction on Montana produced ethanol would affect the blenders federal tax credit already in place. Mr. Reardon said that it would not.
- 00:38:52 REP. WAITSCHIES said that MDT Director Jim Lynch had informed him that the proposed legislation would eliminate the 15% credit. He asked Mr. Reardon if that was correct. Mr. Reardon said that was correct. Mr. Currie said that the current legislation allowing the 15% would go away once there is a plant up and operating to the capacity of 40 million gallons. In the meantime, MDT is losing the revenue from that 15% for imported ethanol.
- 00:39:43 REP. WAITSCHIES asked how the credit would operate. Mr. Currie said that the credit would apply only until the plants are operating. Once a plant is up and producing 40 million gallons, then the credit goes away.
- 00:40:34 SEN. GILLAN **moved** to approve the MDT legislative proposals. Mr. Martin asked Mr. Reardon if any of the proposals could be combined. Mr. Reardon said that he would work with Mr. Martin on that. The **motion passed** on a unanimous voice vote.

DEPARTMENT OF REVENUE LEGISLATIVE PROPOSALS

- 00:42:26 Director Bucks distributed a detailed summary of DOR legislative proposals (EXHIBIT #24). He explained several revisions, saying that they were technical in nature and not substantive changes. He said that by presenting the proposals to the Committee, the Committee and the public are being properly noticed of the ideas and needs of DOR but that he was not asking RTIC to take a substantive position at this time. He said that the proposals would be presented to the full Legislature for consideration. **TAPE 4 - SIDE B** Director Bucks said that DOR has begun the process of meeting with the affected groups to work with them and that DOR has received good input from them. The drafts will be reviewed with them and DOR will continue to take input from the groups. He said that the proposed legislation has several purposes: fundamentally fair taxation for all Montana citizens and businesses, to protect Montana businesses from unfair competition, to clarify and improve the equity and efficiency of liquor laws, to respond to court decisions and audit findings. Director Bucks said that he would not review each proposal but would answer questions from the Committee on any of the proposals. He pointed out that that the priority numbers of several of the proposals has changed and that there may be additional technical revisions as the proposals continue through the process.
- 00:52:40 Director Bucks asked that DOR have the option of presenting Priority 1 -- Abusive Tax Avoidance Transactions -- as two bills, if necessary. He also said that Priority 19 -- Generally Revise Tax Code -- may also need to be separated into individual bills, if certain sections become controversial.

00:56:10 REP. COHENOUR **moved** to accept the DOR bill drafts as recommended by Director Bucks. SEN. ELLIOTT asked for public comment. None was offered. The **motion passed** on a unanimous voice vote.

DEPARTMENT OF REVENUE STATUTORY REPORT

01:13:07 Director Bucks discussed a DOR report on corporation tax water's edge election - tax haven countries (EXHIBIT #25), saying that pursuant to 15-31-322, MCA, DOR is statutorily required to report to RTIC an update of the countries that may be considered as a tax haven.

01:17:31 REP. COHENOUR said that it was her understanding that 2003 legislation referenced this listing so that it would not have to be continually adjusted. Director Bucks said that he didn't think that is how the legislation turned out. He read from the statute the requirements for the listing of the countries and said that he concluded from the language that there is not an automatic update.

01:19:14 Mr. Martin said that the introduced version of bill there may have been a list of countries referenced to the OECD. He said that there was concern that a complete listing be made of the countries that were tax havens and that he would go back and check. REP. COHENOUR said that she would like to know because she thought that the legislation was intended to eliminate having to continually adjust the list.

01:20:34 REP. WAITSCHIES recalled that the concern was that there were other tax havens that were not on the list and that the legislation would allow inclusion of countries that weren't placed on the list by the federal government.

UPDATE ON TAX INCREMENT FINANCE DISTRICTS

01:22:06 Director Bucks displayed a large map of Fallon County and said that DOR denied the certification of values for Fallon County's proposed Tax Increment Finance Improvement District (TIFID). Referring to the map, he said that the blue portion indicated the proposed tax increment finance industrial district and pointed out that the district would coincide with oil well and pipelines on the eastern side of the county and two pipelines. He said that the proposal was denied because the boundaries of the district were not rationally related to identified infrastructure needs. Director Bucks explained the criteria that a tax increment finance district proposal must meet and said that the Fallon County proposal did not satisfy that criteria. He asked Evan Barrett, Governor's Office of Economic Development, who acted as a representative of DOR, to discuss his understanding of the issue, including implications for potential legislation in the 2007 session.

01:27:44 **Evan Barrett, Governor's Office of Economic Development (GOED)**, said that a TIF can be a good tool if used properly but that this particular proposal seemed egregious from the start. He said that the Fallon County was clearly gerrymandered to take advantage of anticipated and planned growth/revenue on the pipelines. Mr. Barrett said that he repeatedly cautioned Fallon County representatives against taking this course of action but that they made the decision to move forward. Mr. Barrett said that Fallon County is now threatening litigation because its request was denied. He said that this situation illustrates

the need for clarification of the statutes. He reviewed the history of the statute and said that a knowledgeable work group has been assembled to work on solutions that hopefully will be finalized for the 2007 session. Mr. Barrett said that he wanted the Committee to be aware that there will likely be a bill and that that part of the bill will have a provision recommending that the 95 state mills no longer be captured as part of the increment. He said that there are some grandfathering issues that will have to be dealt with but that most of the work will be done on the mechanics and clarity. **TAPE 5 - SIDE A** Mr. Barrett referred the Committee to a July 10, 2006, letter to Fallon County Commissioners from the Montana Economic Development Association (MEDA) (EXHIBIT #26) and said that it is his hope that a lawsuit can be avoided.

FINAL REPORT ON HJR 44 STUDY OF TAXATION OF OIL AND NATURAL GAS

01:36:05 Mr. Martin said that Committee members had received via mail a draft copy of the Final Report (EXHIBIT #27) and also a list of proposed topics to be included in the Report (EXHIBIT #28) and that the HJR 44 items were listed on the proposed topics list. He said that the report would also include the memorandums prepared by Mr. Heiman regarding central assessment and on District Court decisions on the validity of DOR decisions on corporations in a unitary operation. He asked if the members had anything they wished to add to or delete from the Final Report.

01:38:45 Mr. Martin discussed the proposed topics for the RTIC Final Report and used EXHIBIT #28 as a guide for his explanation.

01:43:55 SEN. BLACK asked, regarding HJR 44 study, Mr. Martin to check on information from North Dakota and how it addresses this issue. Mr. Martin said that North Dakota was researched that there was a circumstance existing in North Dakota that prevented him from making a good comparison.

01:44:22 REP. MCALPIN asked if information on if the new tobacco tax met or exceeded projections. Mr. Martin said that he would check.

SELECT SPONSORS FOR COMMITTEE BILLS

01:45:00 Mr. Martin said that sponsors are needed for several proposed bill drafts but that assignment of sponsors could be deferred to the next meeting. SEN. GILLAN and SEN. ELLIOTT both supported waiting until November to assign sponsors.

01:45:18 REP. LAKE asked in transportation issues were included in the Final Report. Mr. Martin said that MDT had presented information on safety issues and highway projects but that he did not include them because the issues were not particularly controversial. He said that all of the information and discussion are a part of the Committee's official record but that if the members wanted it to be in the Final Report, he would do so.

01:50:01 REP. LAKE asked to have this meeting's discussion on dyed diesel fuel included and that it will likely be addressed legislatively in 2007. SEN. ELLIOTT asked that SEN. KITZENBERG's presentation on Highway 2 be included. REP. COHENOUR suggested that Mr. Martin review the past agendas and make sure

that any pertinent information be included. She also asked that he research the MDT website to see if links on relevant information should be included and how to access it.

PUBLIC COMMENT

No public comment was given.

01:51:55 SEN. BLACK recalled that Director Bucks has reported that DOR audit collections are substantially less than in past years, that the reason for the lower collections was due to the staff work load required to complete the conversion to the new computer system conversion, and that the numbers would increase once the conversion was completed. SEN. BLACK said that he would like an update on the audit collection numbers. Mr. Martin said that audit collections are a significant component of the revenue estimates and would be discussed as part of the estimating process. SEN. BLACK said that he would like an update sooner than that. SEN. ELLIOTT said that he would ask DOR to accommodate SEN. BLACK's request.

ADMINISTRATIVE RULE REVIEW

01:53:08 Mr. Heiman said that his report on rule review was distributed earlier in the meeting (EXHIBIT # 9) and said that the only other rule was regarding film production tax credits. The proposed rule was a cleanup rule in nature and adopted in June.

OTHER COMMITTEE BUSINESS

01:57:53 Mr. Martin asked if the next meeting date of November 14 could be moved to November 15. REP. MCALPIN asked if the meeting was scheduled to be an all day meeting. Mr. Martin said that the length of the meeting would depend on committee questions and if agreement could be reached between LFD and OBPP on the revenue estimates.

02:00:05 REP. LAKE requested that DOR provide the research data it gathered regarding withholding of nonresident sales and the withholding of nonresident mineral and oil. He said that the DOR report referred to a percentage of 70% and 78%, respectively, and that he would like to see the numbers from which the percentages were developed. He asked that the information be mailed to the Committee in advance of the revenue estimates. SEN. ELLIOTT asked Ms. Gilmer to relay the request on to the appropriate DOR staff. Ms. Gilmer said that she would provide the information to Mr. Martin.

ADJOURNMENT

02:02:35 With no further business before the Revenue and Transportation Interim Committee, SEN. ELLIOTT adjourned the meeting at 3:23 p.m. The next meeting of the Committee is scheduled for November 15, 2006, in Helena.

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