MINUTES

MONTANA SENATE
56th LEGISLATURE - REGULAR SESSION

FREE CONFERENCE COMMITTEE ON SB 111

Call to Order: By **CHAIRMAN BOB DePRATU** , on April 16, 1999 at 8:00 A.M., in Room 405 Capitol.

ROLL CALL

Members Present:
Sen. Bob DePratu, Chairman (R)
Sen. Gerry Devlin (R)
Sen. Mike Halligan (D)
Rep. Chase Hibbard (R)
Rep. Roger Somerville (R)
Rep. Dan Harrington (D)

Members Excused: None.

Members Absent: None.

Staff Present: Lee Heiman, Legislative Branch
Jyl Scheel, Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Committee Business Summary:
Hearing(s) & Date(s) Posted: SB 111, 4/16/1999
Executive Action: None.

SENATOR DePRATU opened the meeting by introducing **SB 111,** the intangible bill. There are a lot of thoughts and ideas that have been put into this bill. There have been a lot of concerns worked on very hard by both Houses and it is now coming down the road toward being in its final form. He felt there was consensus on the idea that main street intangibles are exempt. There are questions remaining on centrally assessed and whether that should be phased in or all at once as well as timing. These are areas of disagreement between the Department of Revenue and the folks from Centrally Assessed.

He stated the committee would recess at 9:00 a.m. and resume again at 2:00 p.m. He opened up the meeting to comments from the committee and comments from the public.

COMMENTS FROM THE COMMITTEE: None.

COMMENTS FROM THE PUBLIC:

Dennis Burr, Montana Taxpayers Association, stated the companies that pay this tax are familiar with the problems and the cost of totally exempting intangibles immediately. They are perfectly willing to see this type of exemption phased in. He felt they could not exempt local and not exempt centrally assessed intangibles. They have to go together and there is a serious constitutional problem if they do not. A phase in is acceptable to these companies to minimize the monetary affect, particularly in this biennium. They suggest a phase in over a period of three years and would like to see that begin in the second year of this biennium rather than putting if off until after the next legislature meets. If it is legislation this session, it makes sense to have it take effect during this biennium.

To minimize the cost, they suggest phasing in the exemption of only 10% of intangibles during the second year of this biennium. With a fiscal note of $9 million dollars, ten percent is $900,000 state and local and about $300,000 General Fund. That should be in a range this legislative session can afford. The rest will be phased in the next biennium.

Mick Robinson, Governors Office, stated, from their perspective, they agree to trying to enter into some phase out of this particular issue. Their concern has been for the financial impact for this particular biennium. As they try to balance the budget and get out of here with a reasonable fund balance, he does not see where there is the financial flexibility to include any more downward pressure on the fund balance at this particular point in time. The Administration is struggling, at this point, with **HB 2** in order to achieve some of the appropriation goals they are looking for. The legislators serving on that Conference Committee are telling them there is no more money and that has to be kept in mind when talking about a tax expenditure. We have to fully understand the impact of a phase out in this biennium is going to have on any fund balance. He gives that as a caution to the committee.

Mary Bryson, Director, Department of Revenue, stated they have a series of amendments they would like to offer to the committee that have been basically agreed to between the industry folks and the Department and the Administration. The only difference has to do with the timing of the starting the phase down and implementation of exemption on intangible personal property. They will get them to Lee prior to 2:00 p.m. meeting.

Jim Mockler, Montana Coal Council, asked that the committee exercise extreme caution in the definitions and the intent included because centrally assessed also includes the gross proceeds of coal. He knows it is not the committee's intent that those parts be included in this bill. The Coal Council has never been a part of intangibles. He would encourage caution to be sure those people included in centrally assessed, such as the gross proceeds of coal, are not included in any way in the fiscal impact.

{Tape : 1; Side : A; Approx. Time Counter : 0 - 8.6; Comments : None.}

QUESTIONS FROM THE COMMITTEE:

SENATOR HALLIGAN questioned the difference in the Department's amendments compared to **Mr. Burr** testimony regarding the phase down and cost? **Ms. Bryson** stated their amendments provide for an exemption for intangible personal property which is centrally assessed and phase that in over three years. The difference is the beginning tax year. They begin the phase down in tax year 2001, which is Fiscal Year 2002. The companies would prefer they begin the phase down in tax year 2000 which would be FY 2001. Their suggestion is to begin that with a 10% phase down in 2001 and then phase down over the next two succeeding years in equal increments of 45%. **SEN. HALLIGAN** asked what percentage the phase down started with in **SEN. DePRATU'S** amendments? **Ms. Bryson** stated 10%.

SENATOR DePRATU questioned how the Department's amendment related to **Mr. Mockler's** concern? **Ms. Bryson** stated they were just talking about centrally assessed costs and would not effect his company.

SENATOR DEVLIN questioned what would be done in 2000 according to the Department's amendments? **Ms. Bryson** stated in FY 2000 they would be writing rules and working with companies to determine valuation methodology that would be adopted to determine the value of intangibles. They would have that done for tax year 2000. They would implement the phase down, taking that intangible personal property out of the value of those companies, over a three year period beginning in tax year 2001. **SEN. DEVLIN** asked if it was 10% in 2001? **Ms. Bryson** stated it was 33%, then 67% and 100% beginning in FY 2003. **SEN. DEVLIN** questioned in what fiscal year did they give the first reduction? **Ms. Bryson**

stated FY 2002 at 33%. The phase down equals one-third, then two-thirds and then 100% so it is one-third more each year to get to 100% phase out of the intangible value. **SEN. DEVLIN** said in 2002 the first reduction would be 33%, in 2003 the reduction would be 67% and in 2004 it would equal 100%.

REPRESENTATIVE HIBBARD stated he was reviewing the 1/19/99 Fiscal Note which showed a $3.3 million dollar impact on the General Fund balance and that is if intangibles were totally exempt. How did the Department arrive at the value of the intangibles? How does the committee know how much intangibles are in centrally assessed? **Ms. Bryson** stated in rounding out that figure, they took the different methods they used to calculate value and market value for the various centrally assessed and compared the correlated system value and compared that to cost value. They made the assumption the difference was the intangible value. **REP. HIBBARD** stated the correlated system value is equivalent to the final market value. The market value less the cost value equals the intangible value.
Ms. Bryson stated the difference between the $10.8 million and $9.5 is that centrally assessed grows at about 2% per year so they project the growth in and would be the loss for 2001.

REPRESENTATIVE HIBBARD asked for an opinion about the value of intangibles. **Mr. Burr** stated it is hard to criticize the numbers that says you don't know what intangibles are nor the value of them. Their method of estimating is probably as good as any. He is not totally convinced that all the difference is intangible when a unit value is higher than a cost factor. The way these companies are assessed on the three factors, you meld them together and come up with a market value for the company. It may be that it might be higher than the cost of the physical property they have and that may not necessarily all be intangible value. That is what the Department and the companies have to figure out before the phase down happens. Intangibles are things like blue sky, good will, proprietary software and things like that. It is hard to think that things like pipelines 16% of their total value is intangibles when 4%-5% of things like telephone and electric companies are generally considered intangible.

REPRESENTATIVE HIBBARD stated if the Department amendments were adopted they had said they would use the first year to value intangibles. Is that correct? **Ms. Bryson** referred to Amendment #4 (4). They will be spending from now until January 1, 2000, writing rules and working with companies to establish a methodology and then spend from January 1 to June, 2000, doing the valuation they do for centrally assessed properties. **REP. HIBBARD** questioned if they would try to come up with a different method to determine what the intangibles are other than the market less cost equals intangibles? **Ms. Bryson** stated it was their agreement and reasonable to say, that if they are going to be removing value from the companies total property value, that they should all agree upon what the value is that will be removed from their value. They agreed they should move forward as well as identifying what the intangibles were and possibly attaching a value to those. That would be the methodology that would be discussed and agreed to by both the companies and the Department through the rule making process.

REPRESENTATIVE SOMERVILLE asked for a spreadsheet on the calculations for the intangible values for PTI and Yellowstone Pipeline in reference to Item #4 of the 1/19/99 Fiscal Note by 1:00 p.m. today. **Ms. Bryson** said they would provide that.

SENATOR HALLIGAN questioned how does the bill proceeding through the process, that does the formula for centrally assessed railroads deal with intangibles? **Gene Walborn, Department of Revenue,** stated the bill is on its way. That bill establishes a formula for arriving at a market value for railroads. In that market value would be included intangible personal property and the Department and the railroads will have to figure out a way to deduct that value out also. **SEN. HALLIGAN** stated he assumed they have looked at other states and professional standards fouled by tax professionals in various departments. How are intangibles dealt with either in formulas or in statute or otherwise? **Mr. Walborn** stated he felt it is a mixed bag. It is handled through tax code or administrative rule or put through methodology. There is some tax administration standards out there they will definitely look into as they develop their approach and methodology for valuing intangibles.

SENATOR HALLIGAN questioned could the phase in prompt litigation and how would that be dealt with? **Dave Woodgerd, Department of Revenue,** stated that is an issue they are trying to figure out. From their point of view, they do anticipate litigation out of this bill. They would proceed with administrative rules and with trying to talk with all the companies to discuss with each segment of this population, i.e. railroads, the pipelines, telecommunications, etc., to talk about the methodology and negotiate an agreement and hopefully adopt rules that would be agreed upon. They will do the best they can to reach an agreement and if that is not possible they anticipate litigation. **SEN. HALLIGAN** questioned if everyone would be included in the rule making process from main street to centrally assessed or will there still be some intangibles? **Mr. Woodgerd** stated under this bill all intangibles are exempt with the exception of centrally assessed.

SENATOR DEVLIN questioned if the Department came up with amendments or who dreamed them up? **REP. HIBBARD** stated occasionally the House makes some minor adjustments to bills that come over from Senate Tax and this is one of those bills. They had considerable testimony in House Tax that pointed some problems. The public had some time to reflect on the $1 million cap placed in the bill when it came over from the Senate and also some things that were not exempt by contracts and contract rights, licenses other than non-transferrable licenses granted by a government. House Tax took the approach they would try to exempt intangibles altogether and make the definition as broad as possible.

SENATOR DEVLIN questioned is centrally assessed the only thing the Department would be phasing in now? **Ms. Bryson** said yes. **SEN. DEVLIN** asked if the menu this bill started out with is all gone? **Ms. Bryson** stated the bill in it's current form exempts intangible personal property from taxation. **SEN. DEVLIN** questioned if a store had a mom and pop name like the Parrot downtown, would they get a tax just because their name was the Parrot because they are not centrally assessed? **Ms. Bryson** said no. **SEN. DEVLIN** said when that section is taken out, everything that is not centrally assessed, what is the approximate cost of that? **Ms. Bryson** said they do not currently value intangible personal property. **SEN. DEVLIN** said there is no impact for that at all. **Ms. Bryson** said it is a tax they currently do not collect.

SENATOR DEVLIN questioned what the other states surrounding us, like Wyoming, North and South Dakota, do on these type of intangibles? **Ms. Bryson** stated she did not know currently. She did know Washington was struggling with this very question. They would provide the committee with that information.

SENATOR HALLIGAN said he anticipated it would take some relatively intensive hearings and negotiations to draft the rules and he would like to make sure the Department has a chance to do it right. He realizes some want the phase in starting this session but he would rather not have litigation associated with the phase in that causes industry more problem. It seems more prudent to wait the extra year as a quicker phase in can happen if using the Department's approach with their amendments. He asked for thoughts on the litigation cloud. **Mr. Burr** does not believe there will be litigation if the phase in is started in 2000 or 2001. If a bill were passed to exempt locally assessed intangibles and tax centrally assessed intangibles then he feels there would be litigation. It would be an equal protection litigation and the state would lose. The major companies understand the cost implications to this legislature. He does not think it will cause litigation as long as there is a phase in.

REPRESENTATIVE SOMERVILLE stated during discussion in the House he was informed there were already a couple of people who had started a lawsuit against Montana over this particular issue. One was Montana Power Company and that their papers had already been drawn, is that correct? **Mr. Woodgerd** stated there is something in the administrative process involving the Montana Power Company and the Kerr Dam license situation.

SENATOR DEVLIN stated other than centrally assessed, this has an immediate effective date, is that correct? Does it disappear upon passage of this bill? **REP. HIBBARD** stated currently nothing is being taxed in the intangibles area and there is nothing in this bill that would change that. **SEN. DEVLIN** stated this bill is telling the Department they are not going to tax those intangibles outside of centrally assessed. He wonders when that takes effect? **Ms. Bryson** stated the effective date in Section 14 is January 1, 2000. The rest of the effective date, since it is not specified, would be October 1. **SEN. DEVLIN** questioned if the Department would have any objection to an immediate effective date on that part? **Ms. Bryson** said that is correct and in fact they would welcome it.

SENATOR HALLIGAN questioned if the Department's amendments had been handed out? **Ms. Bryson** said she would get copies to Lee Heiman.

SENATOR DePRATU said he will be presenting some amendments with a different timing on the phase in, otherwise it would be identical to the Department's. He felt an amendment should be drawn up to reflect **SEN. DEVLIN'S** concern regarding upon passage and approval as far as the non-centrally assessed intangibles are concerned. He requested the spreadsheets from the Department for **REP. SOMMERVILLE'S** request. He would also like information on what the other states are doing. He requested the Department supply this information by 1:00 p.m.

{Tape : 1; Side : A; Approx. Time Counter : 8.6 - 38; Comments : None.}

ADJOURNMENT

Adjournment: 8:40 A.M.

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SEN. BOB DePRATU, Chairman

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JYL SCHEEL, Secretary

EXHIBIT(frs83sb0111aad)