MINUTES

MONTANA HOUSE OF REPRESENTATIVES
57th LEGISLATURE - REGULAR SESSION
COMMITTEE ON TAXATION

Call to Order: By **CHAIRMAN BOB STORY**, on January 12, 2001 at 8:00 A.M., in Room 472 Capitol.

ROLL CALL

Members Present:
Rep. Bob Story, Chairman (R)
Rep. Ron Erickson, Vice Chairman (D)
Rep. Roger Somerville, Vice Chairman (R)
Rep. Joan Andersen (R)
Rep. Keith Bales (R)
Rep. Joe Balyeat (R)
Rep. Gary Branae (D)
Rep. Eileen Carney (D)
Rep. Larry Cyr (D)
Rep. Rick Dale (R)
Rep. Ronald Devlin (R)
Rep. John Esp (R)
Rep. Gary Forrester (D)
Rep. Verdell Jackson (R)
Rep. Jesse Laslovich (D)
Rep. Trudi Schmidt (D)
Rep. Butch Waddill (R)
Rep. Karl Waitschies (R)
Rep. David Wanzenried (D)

Members Excused: Rep. Daniel Fuchs (R)

Members Absent: None.

Staff Present: Jeff Martin, Legislative Branch
Rhonda Van Meter, Committee Secretary

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

Committee Business Summary:
Hearing(s) & Date(s) Posted: HB 61, 1/9/2001; HB 143, 1/9/2001; HB 192, 1/9/2001
Executive Action: None.

HEARING ON HB 143

Sponsor: REPRESENTATIVE ROGER SOMERVILLE, HD 78, Kalispell

Proponents: **Robert Sands**
George Bennett, Montana Bankers Association
Kurt Alme, Department of Revenue
Pat Haffey, Secretary of State's Office
Jim McKeon, Department of Revenue
Mary Whittinghill, Montana Taxpayers Association

Opponents: None.

Opening Statement by Sponsor:

{Tape : 1B}

REPRESENTATIVE SOMERVILLE stated this bill would clarify the income taxation of pass-through entities such as S-corporations, partnerships, and limited liability companies. A pass-through entity is not taxed at the corporation level, but the tax is imposed on each shareholder, partner, manager, or member's share of the income on their individual income tax return. This means a corporation could be taxed at 6% while an individual could be taxed based on individual income, which is 2-11%. In addition, this bill defines Montana source income for residents and non-residents under one of three different methods to file a return and pay any tax due. These methods are: 1) a combination return is filed by the entity and they pay the tax on behalf of all participant non-resident shareholders, partners, managers, or members; 2) a consent agreement is signed by non-residents agreeing to file a Montana individual income tax return and pay any tax due in a timely manner; 3) an entity is required to withhold and remit a tax from a distributive share on income earned by each non-resident. This bill also allows residents a tax credit against their individual income tax and liability for taxes imposed and paid at the S-corporation or small business corporation to another state or county. It also provides a penalty for the failure to file information returns, such as an S-corporation or partnership return within the state. It also requires the Secretary of State to report on any newly established pass-through entities to the Department of Revenue by December 31^{st} of each year. It creates an interim committee to conduct a study on reporting and taxation of income that flows through pass-through entities. This bill is being introduced because pass-through entities are becoming more popular and have steadily increased in the past five years. Montana and multi-state businesses are increasingly conducting business through small business corporations, partnerships, and other alternative entities such as limited liability companies and limited liability partnerships. Federal information indicates the growth of S-corporations has increase 28% from 1997 to 1998, and other state information indicates S-corporation growth within Montana has increased at a rate of 10% per year. State information also indicates the conversion of C-corporations to S-corporations was up 17% from 1998 to 1999. The Department of Revenue records show 8306 partnership returns were filed in 1994 and 10,389 in 1998. This is an increase of 25%. The Secretary of State reported approximately 5500 limited liability companies registered in 1999. Partnerships in S-corporation tax return information that must be submitted to the Department of Revenue is limited, and compliance with Montana tax laws by non-residents is lacking. A recent compliance project was conducted by the Department of Revenue resulting in additional revenues of about $634,000 from non-resident S-corporation shareholders and another $214,000 from non-resident partnerships not filing a Montana individual income tax. The total is approximately $850,000 we are currently losing per year. By revising the income taxation of these pass-through entities defining the various types and requiring them to file a composite return, withholding from distributive shares, or requiring a shareholder to file a consent form, the tax gap created by non-voluntary compliance and by non-residents should be reduced. **EXHIBIT(tah09a01)** The handout is proposed amendments to clean up the language even more. On the fiscal note there is a projected increase of income to the state in FY2003 of $1,185,000. On the back of the fiscal note is explanation of how these figures were derived. There is a section of the bill stating if a resident is paying pass-through entity taxes to another state, this will be deducted from their Montana income tax. This is in subparagraph 4 and also provides a resident taxpayer is entitled to a credit against individual income tax for the share of income taxes paid to another state or country by the S-corporation of which the individual is a shareholder. Based on case studies conducted by the Department of Revenue, this credit is estimated to reduce the individual income tax revenue by $115,000 each year.

Kurt Alme, Director, Department of Revenue, added additional introduction and explanation of the bill. He said the primary purpose of this bill is to address how they get reporting and compliance from out-of-state residents who are shareholders, members, or partners in a pass-through entity. They also ask the committee to suggest to an interim committee that they consider pass-through entity issues on a broader scale. A pass-through entity are S-corporations, limited liability companies, and partnerships. They do not pay tax at the entity level but pass through their income deductions to the shareholder or owner level where taxes are paid at the individual level, so there is not a corporate license tax paid on it. Section 1 is merely a housekeeping provision to eliminate references to subsections. Every time a section gets changed and a new subsection gets added, they have to amend all the cross references, so they are beginning a project to eliminate references to subparagraphs and subsections. Section 2 deals with definition clarification, specifically C-corporation, dividends, Internal Revenue Code, limited liability company, limited liability partnership, Montana source income, non-resident, partner, partnership, pass-through entity, and S-corporation. Section 3 is to make clear that all partners, shareholders, and managers of limited liability companies all need to file a return. Sections 4 and 5 try to make clear how out-of-state residents can file. There is a significant noncompliance problem with out-of-state residents who are members, partners, or shareholders who are not filing returns, and they think the revenue impact to the state is over $1,000,000 per year. In order to do this, they have provided for three ways they can file. The first option is a composite return, which is a combined individual income tax return filed by all the non-resident owners of an entity. They prorate out their share of the tax liability and pay that based on individual income tax rates. There are 14 states that allow for this filing. If non-resident taxpayers do not want to file a composite return or the entity does not want to file the return for them, then they can file a separate individual income tax return, but if they are going to do that, they need to sign a consent agreement with the state recognizing that they realize they need to file a return. This consent will give information about where they are located and make sure this return is filed. If a taxpayer does not chose either of these methods to file, then the Department of Revenue needs the pass-through entity to withhold. Then the state is guaranteed they will get the revenue if they are not going to comply with either of the two other mechanisms. The consent agreement option is currently used by 5 states, and the withholding is used by 17 states. Section 6 clears up a problem between Montana law and other state law. If a resident pays tax on income in another state, they get a credit for that income tax paid in your resident state so they are not paying on that income twice. If pass-through entities were treated the same, this would not be a problem, but some states do not treat pass-through entities and pass-through, and they still pay tax at the entity level. It is suggested that if you do pay tax at the entity level, the proportionate share of the tax paid attributable to the taxpayer can be treated as a credit against Montana individual income taxes. Section 7 is an addition to clarify no income gain, loss, deduction, expense, or credit may be counted more than once in determining Montana source income. Section 8 sets forth what you have to file with the Department of Revenue and provides a penalty for failing to file. Currently there is no consequence, so it adds a penalty of $50 multiplied by the number of partners, shareholders, managers, members, or other owners that exist at close of the tax year. Section 9 is merely housekeeping deleting some subparagraph references. Section 10 includes a definition clarification. Section 11 deals with the Montana tax credit for endowed philanthropy, which says if you are a Montana resident through a pass-through entity to a Montana charity held in endowment, you are entitled to a 50% tax credit of up to $10,000. They are not impacting that credit. The state does not allow individuals to just give cash to an endowment to qualify for the credit, but they do allow business entities to give cash. The reason for this historically is that charities were concerned if they allowed individuals to make contributions to their endowments directly, they would not make contributions directly to the operation fund of a corporation, so endowments would grow but the charities might go out of business in the short-term. An abuse occurring is people are setting up pass-through entities for the sole purpose of making the tax credit. This is just a clarification that if you are going to have a pass-through entity, it must have a business purpose. Section 12 defines small business corporation. Section 13 requires that new entities file with the Secretary of State's office, who will then provide a list to the Department of Revenue of the pass-through entities so they can be sure they are getting all the proper returns. Section 14 refers to the pass-through entity committee. He will leave this to the committee of how best to handle this whether it is dealt with in this bill or amended out to be left for another bill. The last three sections are housekeeping. In Section 17, the applicability date states this applies to tax years beginning after 12/31/01. The amendments deal with the term "entity disregarded" for Federal income tax purposes as it might be unclear, so they have suggested a subparagraph that defines this term and add more clarity. Amendment 6 adds clarity to the term "amount." Amendment 10 clarifies the endowment section and defining trade of business.

Proponents' Testimony:

Pat Hathy, Deputy for Operations & Business Services, Secretary of State's Office, stated they support this bill and stand ready to help the Department of Revenue in providing the list of entities they need.

George Bennett, Attorney, Montana Banker's Association, said the theory of the S-corporation was that small family owned or closely held corporations which could be business in partnership form should not be penalized by having to pay both the tax on the corporate and shareholder income simply to obtain the protection of incorporating; however, under Federal law until about 5-6 years ago, banks were required to be corporations. They have been advised by the Certified Public Accountants, and they understand the accountants have not had a chance to look at the bill, so the committee may want to allow them to do this. He sees a conflict between Section 4 and 5, but he would feel more comfortable if the CPA's had a chance to look at this. Senator Alvin Ellis has SB 173, which is a major revision of the Income Tax Act, and he believes this bill contains a lot of these same provisions.

Robert Sands is here as an individual taxpayer and has previously practiced tax law in Minnesota. There is a definition in this bill of a corporation, and he believes the Department of Revenue should be aware there is a possible redundancy, because that provision is already defined. He suggests they either avoid having two definitions or they use precisely the same terminology. He supports the Department in an amendment whereby they do not use the term "disregarded." There has been extensive litigation under the Internal Revenue Code on what entity is recognized as a corporation or an association taxable as a corporation under Section 77-01 of the Internal Revenue Code. These provisions primarily go back to the Internal Revenue Code and those words precisely that define that entity for Federal purposes and should be used by Montana as well. Section 6 is of personal interest, and he personally does not regard it as a change in law and believes that is what Montana law says now. There is also a change in that language which he thinks is not helpful. The verbs in the first two sections used is the verb "is," whereas in the present section it says "shall," and he thinks "shall" is a standard term of legal terminology which means that is the way it is going to be. "Is" is a softer term. Consistency is desirable with the term "shall." Section 15-30-133, 3(b), has a phrase "any tax," which he says is too broad. The only tax applicable here would be the built-in gains tax on S-corporations. 15-31-101 is the existing definition of a small business corporation and is the section he previously said has redundancy. In the definition of Montana source income, by listing them individually could potentially inadvertently omit something.

Mary Whittinghill, Montana Taxpayers Association, said they have offered some amendments to Representative Somerville and the Department of Revenue unaware they were presenting amendments today, and some of their amendments have taken care of some of their concerns. They would like the opportunity to work further in clarifying some of the sections of statute.

<u>Opponents' Testimony</u>: None.

Questions from Committee Members and Responses:

REPRESENTATIVE BALYEAT asked if this bill is a tax increase or if it was simply putting in writing rules the Department of Revenue has already been going by but wanting to clarify. If it is simply clarifying rules already in place, why does it show a $1,185,000 positive fiscal note. **Kurt Alme** said this is not a tax increase. This positive revenue comes from out-of-state residents paying the tax they are already obligated to pay that they are currently not paying. Most of the bill is clarifying what the law already is. Sections 4 and 5 talking about how they have to file is new, so they are trying to make sure out-of-state residents actually file and they are able to get them to file. The dollar amount came from an audit program done in 1994-1995 specifically aimed at out-of-state residents who are not complying with our tax low for pass-through entities, and it generated revenue positive to the state of $1.12 million. **REPRESENTATIVE BALYEAT** suggested they consider combining this corporate tax reform with some other types of tax reductions, because legislators and government would probably support tax reform packages on a whole. He understands Senator Ellis has some of these provisions in his individual income tax package. He asked if they have looked at this consideration. **Kurt Alme** said they would certainly be willing to entertain presenting this bill in any form deemed best by the committee.

REPRESENTATIVE DEVLIN asked what the transition period was and if there would be a promise of these figures exactly. **Kurt Alme** said they have focused on this revenue estimate closely. This does not go into effect until 1/1/02 and for the first six months, they are not expecting any additional revenue, so they are being conservative with that figure. Going forward they have based estimates on audit compliance figures from 1994-1995 and multiplied this by the number of out-of-state non filers that exist now. He cannot promise those dollars exactly, but they have confidence with that number.

(Note: There is no taped documentation of the next series of questions due to microphone malfunction.)

REPRESENTATIVE JACKSON asked a question of **Kurt Alme**.

REPRESENTATIVE SCHMIDT asked a series of questions that **Kurt Alme, Don Hoffman, and Pat Hathy** responded to.

REPRESENTATIVE ESP asked a question of **Kurt Alme**.

REPRESENTATIVE LASLOVICH asked a question of **Kurt Alme**.

REPRESENTATIVE WAITSCHIES asked a series of questions that **Kurt Alme and Jim McKeon** responded to.

REPRESENTATIVE SCHMIDT asked a question of **Kurt Alme.**

REPRESENTATIVE ERICKSON asked a question of **Kurt Alme.**

Closing by Sponsor:

REPRESENTATIVE SOMERVILLE said this bill is very complicated. There will possibly be a subcommittee appointed and they will work with the Department of Revenue, Robert Sands, Montana Taxpayers Association, Senator Ellis, and others to clean up some of the questions that were raised. He believes this bill is not a tax increase but tax equity and fairness. Taxes should be paid by all and paid equally by all who owe in Montana. He is willing to work with anyone and is working directly with Kurt Alme on this bill.

HEARING ON HB 192

Sponsor: **REPRESENTATIVE DOUG MOOD, HD 58, Seeley Lake**

Proponents: **Harold Blattie, Stillwater County**
John Lawrence Ashmore
George Bennett, Montana Bankers Association

Opponents: None.

Opening Statement by Sponsor:

REPRESENTATIVE MOOD said there should be an option for people in Montana to pay by credit card. As we move more toward Internet and electronic means, it only makes sense to have this capability. A survey was done by the Federation of Tax Administrators in 2000 showing 44 states surveyed, and of those 44 states, only 5 do not currently have an option of paying taxes by credit card. There will be discussion about who should pay the credit card fee. Of the 22 states listed, 8 of them the state pays the fee and 16 of them has the taxpayer pay the fee.

Proponents' Testimony:

George Bennett, Montana Bankers Association, said we are moving into the electronic age, and the Secretary of State has a bill in this session to allow electronic signatures and electronic transactions, which is the wave of the future. He thinks the taxpayers should pay the fees.

John Lawrence Ashmore said he is from Connecticut and they allow individuals there to pay income taxes by credit card. When he moved to Seeley Lake, he was allowed to pay his property taxes through the county by credit card with no fee to the taxpayer. When he went to pay his Montana income tax, he was surprised that he could not do so. Most citizens recognize the need to pay taxes; however, the process of paying taxes is often done reluctantly. This reluctance can be partially diminished by allowing individuals to pay be credit card. Many cards provide incentives for their use and paying by credit card allows individuals to take advantage of these programs. Another benefit is if an individual finds himself in financial difficulty at tax time, he can discharge that debt over a period of time if he can pay by credit card. Also the country is moving toward a paperless economy and the process to pay taxes online will be a necessity. The fee for the process should be paid by the government rather than the individual taxpayer.

Harold Blattie, **Stillwater County Commissioner**, said this bill is a good start in the right direction to move into the new economy. We need to enable residents and taxpayers to enter any transactions they choose to, such as registering their motor vehicle, paying property taxes, or paying income taxes using the convenience of credit cards. A credit card is the basis of the new economy enabling electronic commerce.

Opponents' Testimony: None.

Informational Testimony:

Jeff Miller, **Department of Revenue**, offered the committee the Department's experience with credit cards. In 1989 and 1990, they did accept credit cards where there was a transaction fee added to the amount the customer chose to pay. It was popular because it allowed the customer the flexibility of spreading out their payments, it took the Department out of the picture in terms of any penalties and enforcement action, and it was well received but not heavily used. In 1991, they put the same opportunity in front of taxpayers in the tax booklet, again well received but not heavily used. They discontinued that practice in 1992 because the credit card companies had not understood they were adding on the transaction fee and was at that time against their internal policies. Subsequently the credit card companies have changed those policies and the Department has again offered credit card use in a limited way. They presently accept credit cards in one stop licensing, where on behalf of six other agencies and the Department, businesses come to them to renew licenses. The way this is handled now is for example, the bill was $100 and there was a 2% credit card usage fee, they would present clearance to the credit card company, they send the Department $98, and they distribute that $98 proportionately among the agencies. In effect, the State is paying that fee presently. They would like the opportunity to work with the sponsor to clarify how this mechanism would work.

Questions from Committee Members and Responses:

REPRESENTATIVE CARNEY asked what the statement of "discount or otherwise" meant. **Jeff Miller** said this indicates they would be able to handle this as they are now. The discount would come from the proceeds and the net would be distributed to the funds. In effect, the State would be paying for that out of the receipts and would not be an add on to the customer. This is exactly the clarification they would like to offer by amendment to be sure this is how it would operate.

REPRESENTATIVE LASLOVICH asked how much the credit card company fees are. **REPRESENTATIVE MOOD** said he thinks the Department should take care of the fee. One of the reasons is that the fees are apparently negotiable and believes the Department is in a position to negotiate a lower fee than what would otherwise apply. The fee amounts listed in other states vary from 1.7 to 2.5, and he is assuming that is a result of negotiations. Another reason the Department should pay the fee is that they are collecting all the money and it is much easier for them to pay it from a pool of money rather than for each individual taxpayer.

REPRESENTATIVE FORRESTER asked why there was no fiscal note if the Department is going to pay the fee. If the Department has to pay the fee, there will be an impact there. **REPRESENTATIVE MOOD** said there was no fiscal note requested. In his conversations with Jeff Miller, he indicated their estimates of the number of people who would use this and the fees attached to that figure would be $20,000 per year. **REPRESENTATIVE FORRESTER** asked if a fiscal note could then be prepared. **REPRESENTATIVE MOOD** said that it could.

{Tape: 1A}

REPRESENTATIVE ERICKSON asked if they see a potential increase in the use of credit cards and if they would agree to an add-on fee. **Jeff Miller** said he agrees there is an increase in the trend to utilize credit cards and would very likely see a growth in the use. The Department would like to be in a position to promote this because it streamlines the access to customer service. The IRS does add a convenience fee ranging from 2.5 to 3%. They have an add-on situation and continue to expect growth. They are prohibited specifically from absorbing the fee by the Taxpayer

Relief Act of 1997. **REPRESENTATIVE ERICKSON** suggested they do get a fiscal note and try not to be conservative about the number of people who might be using this.

REPRESENTATIVE CARNEY said there was a discrepancy in the testimony regarding local government to allow credit card payments and wanted clarification as to what is allowed. **Jeff Miller** said this bill is specifically for income tax. He was unsure which local governments currently accept credit cards.

REPRESENTATIVE SOMERVILLE said he heard in testimony local governments should be included in this process. In a past session, county treasurers were opposing this process because it would cost the counties money to set up and run the system. He asked to what extent this should be expanded to local governments. **Harold Blattie** replied the representative was correct. It is not clear in the statute that local government does have the authority to use credit cards as a means of doing transactions because of the discrepancy of adding on or absorbing the fee. There was a committee who spent the last year looking at electronic commerce issues, and they would like to see in statute enabling but not requiring counties to have an active web site allowing credit card transactions through secure servers. **REPRESENTATIVE SOMERVILLE** asked if there could be an expansion to the counties included in this bill or possibly designate a committee bill later if this is an issue they choose to pursue.

CHAIRMAN STORY asked how much leeway a state or county would have in negotiating agreements with credit card companies and if they have current policies against the add-on fee. **George Bennett** said he would get the answer for them. The Montana Independent Bankers Association owns a credit card system and thought they could get that information quickly.

REPRESENTATIVE WADDILL asked how big a problem credit card debt is and to what income levels this usually pertains to. **George Bennett** said he thought those figures were available through the Montana Bankers Association and would get this along with the other information requested.

REPRESENTATIVE FORRESTER asked that if he paid taxes on time if he would get the same discount as paying by credit card. **Jeff Miller** said unfortunately no.

Closing by Sponsor:

REPRESENTATIVE MOOD said credit cards and electronic transactions are a reality, and if there are people who abuse credit cards, it is not a problem the State should take on. There is some perception each time the credit card issue comes up that somehow the State is encouraging bad responsibility, but this is not the case. They are just trying to modernize the statutes and making it convenient for people to pay their taxes. He would be open to amendments from the committee.

HEARING ON HB 61

Sponsor: REPRESENTATIVE ERICKSON, HD 64, Missoula

Proponents:
Eric Feaver, MEA-MFT
Don Judge, Montana State AFL-CIO

Opponents:
Jim Mockler, Montana Coal Coalition
Mike Foster, Governor's Office
Don Allen, WETA
Barry Stang, Montana Motor Carriers Association
Mary Whittinghill, Montana Taxpayers Association
Charles R. Brooks, Billings Chamber of Commerce
Amy Orser
Webb Brown, Montana Chamber of Commerce
Senator Mike Taylor
Senator Bob DePratu
Representative Doug Mood
Riley Johnson, National Federation of Independent Business

Opening Statement by Sponsor:

REPRESENTATIVE ERICKSON said this bill freezes the business equipment tax at 3%. There is a mechanism in which to start to reduce that tax from 3%. In the fiscal note there is no fiscal effect of this bill this year, but we are on a path to a major loss of revenue. There is a flawed economic theory of the need to lower the rates lower than 3% because the present rate is not competitive. **EXHIBIT(tah09a02)** He asked to look at tables 3A and 4A in this handout. There is a possible loss of up to $200 million. It was known Class 6 livestock was going to go to 0% and that intangibles were going to be fully exempt. What was not known was the magnitude of the intangibles being exempt. On the fiscal note two years ago regarding the intangibles, it suggested two years out there would be a $10 million hit to cash flow. During the special session and update was given of $15 million. By that Fall, it was $17 million, and then later moved to $20 million. A number of years ago the legislature decided pollution control and equipment were important and that we would give a tax break to businesses putting in pollution control equipment at 3%

rather than 9%. The pollution control equipment is now in Class 5 from Class 8. Why should they pay 3% if Class 8 is paying 0%. ***{Tape: 2; Side : A}*** In recent years, the amount of income coming in for salaries and wages versus capital gains was 11 to 1 and is now 8 to 1. Looking at the current stock market, at some stage the growth we have been seeing in capital gains income is going to decrease. **EXHIBIT(tah09a03)** About a year ago, he had asked that an analysis be done regarding the trigger, and this handout is an update of that. If the real wages and salaries percent change is more than 2.85%, the trigger has been met. The trigger was met in 1992, 1993, 1994, and 1998. The argument for these years is that the economy is in such bad shape we need these business tax equipment breaks. He suggests this is the wrong trigger. The estimates from the Department of Revenue is that we will not hit the 2.85%, but he does not necessarily believe this. **EXHIBIT(tah09a04)** Incentives matter and lowering the business equipment tax allowed companies to buy more equipment. Whether this will bring businesses into the state is unknown.

Proponents' Testimony:

{Tape : 2; Side : A; Approx. Time Counter : 11.1}

Don Judge, Montana State AFL-CIO, said the sponsor has adequately pointed out the concerns about the revenue. Across Montana cities, counties, and school districts are seeking additional revenue as a direct result of the passage of SB 200. 97% of the reduction in property taxes falls on local government and school districts. They will be asking the legislature for ways to offset this loss. The sponsor mentioned he thought maybe the incentives were working and there was more business equipment moving into Montana with economic development. Out of the top 20 businesses in Montana, only 2 have generated new jobs, and these had plans to generate these long before SB 200. Advanced Silicon in Butte built and expanded because of a tragedy in Washington. Their decisions are not based on Montana taxes as much as they are the sale of their product nationally. Stillwater Mine had been going through a permitting procedure to expand for 5-10 years. The other companies have laid off workers, remained stable, or shut down. They do not think the decrease in business equipment tax has brought in economic development. The ambassadors of Montana say the number one issue for business retention and expansion is a qualified, trained work force. Resources have been taken out of education and training.

Eric Feaver, MEA-MFT, has previously worked with communities on tax reform packages which included a sales tax. It has been said that if property tax base is given away, it will grown the economy in a sufficient fashion for income taxes to make up the difference. The property tax is in serious trouble as there is nothing to replace this except a promise that maybe there will be a growth. It is not known if reducing the business equipment tax to 3% is going to produce great revenue benefits for Montana and grow the economy. This state has a choice to grow the economy only by tax reductions as SB 200 has suggested or grow it with a mix of tax reductions and investment in education. Schools and university systems are struggling for a few reasons. Montana communities take pride in the quality of our schools. A national report shows the performance of our students are in the top 10. This will not happen forever if there is no revenue to pay.

<u>Opponents' Testimony</u>:

{Tape : 2; Side : A; Approx. Time Counter : 25.8}

Senator Mike Taylor said he carried SB 200 last session because he studied the history of Montana and other states which showed economic development and infrastructure follows low taxes. There has been over $100 million in capital investments over the last two years. It is unknown whether this is due to a lower tax rate, but he does know when there was a 12-15% rate on the business equipment tax we lost most of our coal production to Wyoming along with jobs. Education and job training is very important, but other states have lower equipment tax, and we export over 70% of our college graduates. There has to be stable lower tax in business and any tax to be able to stabilize the job market so our children can get a good paying job in Montana. The trigger was based on a high benchmark agreed on by the committee, because they believed with lower taxes given time the wages and labors in Montana would increase. Let free enterprise and the trigger work.

Mike Foster, Governor's Office, said a major focus of the Martz-Ohs administration is economic development. The governor will support existing employers and attract new ones to stimulate the number of jobs available for Montanans. Reduction in business equipment tax approved during the last session will provide employers about $60 million in tax savings that can be used for re-investment and new jobs that will make Montana more competitive with our surrounding states. This trigger will not occur unless there is significant growth in Montana's inflation adjusted wage and salary income, which is a combination of economic growth and relatively low inflation. It is all projections. If by chance the projections Representative Erickson presented as his view, then there will be opportunities to address those concerns. The general doom and gloom message should be respected, but at the same time, the governor believes SB 200 is an important mechanism in the economic success of

Montana. The tables handed out by Representative Erickson are the analysis based on "what if." If the trigger occurs it means there is economic success in Montana, which is a good thing. It is hard to compare tax systems from one state to the next because of variables such as sales tax. There are many factors involved in what occurs with business affecting jobs. There are concerns about school, and the governor has made education a major topic of focus. Schools closing are usually because local economies are suffering.

Senator Bob DePratu said a jobs and income committee last session, and people explained to them why they felt Montana's economy was faltering and not expanding. One thing stated was that the equipment tax was uncompetitive with surrounding areas. They developed SB 200 under the direction of Senator Taylor and has become a very effective bill. Senator Baucus invited corporate people to get feedback of why or why not they would come to Montana. They expressed the reduction in the business equipment tax would aid in an environment to help them to want to come here. They also said our income tax was too high, as well as problems with regulations. They also spoke of stability of policy. If we stop the tax at 3% and change this, the tax policy cannot be depended on and businesses will not want to come here. There have been a lot of good jobs lost due to regulations by Federal government. Plum Creek is in the process of building a $70 million expansion creating new jobs. They made the decision to do this in Montana instead of Washington because SB 200 was passed. Two years after the bill was passed, we are not seeing economic development because it takes 5-6 years to see the results. Good tax policy will help companies make the decision to make a wise investment by investing their money in Montana.

Representative Doug Mood sponsored SB 200 on the House Floor during the last session because he believed the tax policy changes being set were absolutely essential for Montana to go forward as a viable state in which to do business. We could tax businesses involved in resource industries almost at will because they had to be here because this is where the resource was. The reality in today's society is there is a mobile business climate. Montana is competing with every state to attract business. We cannot do that with a tax policy based on the industrial revolution.

Charles Brooks, Billings Area Chamber of Commerce and Montana Retail Association, said one of his major concerns with Montana's tax policy is the lack of liability, predictability, and stability. We are now going in the direction to encourage businesses to invest. While he was in retail business in Louisiana and Montana with identical stores, the taxes in

Louisiana were half of the store in Montana. This is not the time to get rid of trigger mechanisms.

Riley Johnson, National Federation of Independent Business, said 83% of their members were in favor of SB 200. Their biggest contribution to economic development would not necessarily be in doubling their work force but they would buy new office and business equipment for the small employers. It has occurred among the members.

Mary Whittinghill, Montana Taxpayers Association, said they believe it is premature to even be discussing the trigger because it does not occur until 2004. Taxpayers just recently received the savings from this legislation in November when they paid the first half of their 2000 tax bill. The economic benefit resulting from this type of legislation needs to be looked at. The tax shifting sheets handed out to the committee are not reflective of any benefits to the economy in Montana as a result of increases in income, investments, or attracting new businesses. A $10,000 piece of manufacturing equipment now in Montana would pay approximately $969 in taxes over the life of that equipment. If this is compared to a sales tax state, it is 2-3 times higher. A poll is being conducted throughout Montana of businesses and will be finished soon. 60% of the businesses who have returned the survey are investing in new equipment and discussing employee raises and new employees.

Webb Brown, Montana Chamber of Commerce, said they believe SB 200 is critically important as one of the components of economic development for Montana. The projections do not include other factors they felt would also be improved with incoming corporations. The trigger would not take place until 2004, and it is premature to be looking at something that has only resulted in tax savings just in the last couple of months. There is competitive factors with other states. One of the components businesses responded to in the survey was tax reform was essential and incentives do matter. The business equipment tax is one of many factors that is a component of a business' decision to expand, stay in business, or to come to the state. He agrees local governments are hurting, but part of the reason for this is businesses are hurting. It is good to see wage growth and hopes the business equipment tax reduction has been a contributing factor to this.

Jim Mockler, Executive Director, Montana Coal Council, said the coal companies have paid $2.5 billion in taxes over the last 20 years. The companies' average salary and benefits exceeds $60,000 per year, so these are the types of jobs to encourage.

Informational Testimony:

{Tape : 2; Side : A; Approx. Time Counter : 63}

Evan Barrett, Butte Local Government, said he has been doing economic development for 15 years and interface with companies who address what elements bring them to Montana to do business or allow them to expand their business here. There is a broad range of issues considered when making decisions on investment, and taxes are but one. The tax policy generally averages, depending on the study, the 5^{th} or 6^{th} level of concern of a corporation. They also find the companies address the total bottom line of taxes, not any single tax. They compare this with other states and locations. The predominant issues they face today when talking to companies are work force issues, availability of work force, skill level of work force, ability to train, higher education research and development issues, utility rates, communications, and quality of life (medical, education). Business equipment tax is only one issue in dealing with economic development.

Debbie Whiting, Montana Association of Churches, wanted to remind the committee there are a lot of people in poverty in Montana and the poorest are the children. 25% of the children under the age of 5 are in poverty. She is asking to make tax decisions based on concern for the vulnerable people. She read a statement from their economic justice paper. "Economic choices and institutions must be judged by how they serve the common good, support the family, and protect the life and dignity of an individual. The marketplace does not exist in a vacuum. Ultimately we who shape it and are shaped by it are accountable to God. A just economy gives all persons access to the basic material necessities of life. When some people are excluded from the abundance of life which God intends for all persons, justice is denied. Two signs of injustice in our world are the great numbers of people in need and the great gaps between the rich and poor."

Questions from Committee Members and Responses:

{Tape : 2; Side : B; Approx. Time Counter : 6.6}

REPRESENTATIVE BALYEAT asked how fast this "precipice" was coming and if this issue could be addressed in a future session. The fiscal note states the earliest this Class 8 tax rate could begin to be phased down is 2004. Even in 2004, the net impact is approximately $1.5 million. Compared to HB 70 presented by Representative Erickson was a negative $3.5 million, so in 2004 this is less than half of what Representative Erickson is asking for in a tax reduction. He asked if it was correct that 2004 is the first possible year this could have an impact and if he agrees that in the short-term the impacts of the bill or not that precipitance whether the decision is made now or in two years. **REPRESENTATIVE ERICKSON** replied he did realize this as he stated in the opening. In 2004, if you start to see an effect it means the effect continues. The important point is we are very near that "precipice."

REPRESENTATIVE BALES asked why there was a difference between the effective tax rate of 2.9% on the Class 8 property on Raw Data on Wages and Salaries and the effective tax rate of 1.24% on States that Exempt Personal Property. **REPRESENTATIVE ERICKSON** said the effective tax rate is the percentage times millage, the average millage in the state is 420, and that is how you get from the 3 to 1.2. **REPRESENTATIVE BALES** verified the 1.24% was times the millage. **REPRESENTATIVE ERICKSON** answered yes, it is the 3% times the millage. There are other decreases in property value thrown into the calculated 2.9% as seen at the bottom of that page.

REPRESENTATIVE SCHMIDT said Senator Taylor mentioned $100 million in capital investments in the last year and asked if the Department of Revenue has proof of that. **Brad Simshaw**, Department of Revenue, replied he does not personally have any knowledge of that. **CHAIRMAN STORY** said on Representative Erickson's Raw Data sheet for business equipment between 1998 and 1999, it is about $100 million, and that is probably where those numbers came from. **REPRESENTATIVE SCHMIDT** asked if Don Judge could comment on his reaction to the mention of coal in Wyoming. **Don Judge** replied there are a lot of factors dealing with our Montana coal. It has not been selling the way the Wyoming coal has, one reason being the quality of the coal in Wyoming as better burning coal. Although there is similar coal in Montana, we have not accessed that coal. It is also a matter of access to markets and their ability to get their coal to market, which is easier than us. Montana is not in as good of a competitive position for those reasons as well as others. In Wyoming they have a sales tax and rely heavily on mineral resource taxes for funding governments sources. **REPRESENTATIVE SCHMIDT** asked if the figure of 70% of Montana's college graduates leave the state was accurate. **Eric Feaver** said this was close to accurate but varied from institution to institution. The Colleges of Technology in Montana retain nearly 90% or better. **REPRESENTATIVE SCHMIDT** asked when we would see the benefits of the business equipment tax reduction in terms of business expansion and/or development. **Mike Foster** replied that we all would like to predict the exact time to see the benefits from any program, and Senator Taylor indicated some of those benefits are happening now. **REPRESENTATIVE SCHMIDT** asked if the governor has factored any of this into the revenue estimates. **Mike Foster** replied the revenue estimates would be for the next biennium, and the trigger on this bill does not occur until 2004, which would be in the biennium beyond this one.

REPRESENTATIVE WANZENRIED asked if it was accurate that no matter which scenario and what level there would be a shift from business property to residential property taxpayers. **Brad Simshaw** said the assumptions with scenario one was that the mills were held constant and the shift was still seen. The second scenario was mills were increased to result in the same amount of property tax revenue and there was a shift to Class 4 residential. **REPRESENTATIVE WANZENRIED** asked if it was true that if the millage was increased it just compounded the shift. **Brad Simshaw** said the increase in mills would affect all remaining property on the property tax base, so it would affect commercial real property, agricultural land, and residential. **REPRESENTATIVE WANZENRIED** asked what proposals the administration would have in the next two years that will help school districts offset the losses assuming the projections are not accurate. **Mike Foster** said they can speculate as to the future, but until there is more solid information about what is happening between now and the time they prepare for the next legislative session, they simply cannot say for sure what anyone would propose. **REPRESENTATIVE WANZENRIED** asked if it was fair for the ones not convinced of the correlation between tax policy and economic development to ask if there are projection models available to project what kind of development would take place and what kind of tax receipts could be expected. **Mike Foster** said it was fair to ask for any kind of models the legislature would like to see and believes the Department of Revenue will do their best to provide that information. The administration will be watching all aspects of our economy very closely. Education is a big priority. **REPRESENTATIVE WANZENRIED** asked that as the property tax base is diminished on a local level how the schools would function without that revenue. **Mike Foster** replied the representative assumed in his statement there would be no economic growth and the tax base would decline. This is dependent on the business community, so until it is seen what happens there, then they will be able to address that question. It is understandable those entities relying on those tax dollars are going to express concern about any tax proposal.

REPRESENTATIVE LASLOVICH said the governor makes education a focus, but it was also said education would be affected by local governments suffering. In Table 4A of the handout it says local governments would lose $142.5 million if SB 200 remains and asked if Mike Foster agreed with the point. **Mike Foster** said the table is based on assumptions based on a worst case scenario. The

Department of Revenue would have to explain the assumptions. Schools who have been contemplating closure or consolidation are mostly on the highline, and if these areas were experiencing great economic growth, the schools may not have been inclined to consolidate, but in the rural areas of Montana the economies have had some troubling times and as a result some decisions have had to be made about the local schools. **REPRESENTATIVE LASLOVICH** asked if these local economies are going to suffer what does the administration intend to do to help these local governments that will be losing money with regard to the tables. **Mike Foster** reminded of the intent of SB 200. The trigger mechanism will not occur unless Montana is experiencing very good economic growth. The indication then is the local economies must be doing well or improving in order for that trigger to occur. When it is said the economies are suffering with the fact the trigger is occurring, it actually indicates the economies are improving. **Kurt Alme** added there is a local government funding bill to be discussed to address the impact on local government.

REPRESENTATIVE BALES requested a comment regarding the difference between the significant difference in tax structure between Montana and Wyoming. **Jim Mockler** said the 1975 legislature passed a 30% severance tax on the coal industry. Wyoming has some advantages to markets going south. Montana has an advantage into the upper Midwest. This decision by the legislature showed to the industry and railroad that Wyoming was a better place to do business. So they built their lines and infrastructure there. Montana has a higher quality and BTU coal and should be producing around 150 million tons of coal. Wyoming produced 365 million tons last year. This race was lost and it was primarily over the taxes.

REPRESENTATIVE SCHMIDT asked if Mary Whittinghill could repeat an answer to a question she had asked of her earlier in the year regarding the tax going to zero and the impact on telecommunications. **Mary Whittinghill** said that taxes matter and even at the 3% Montana is still not competitive with the states near us. Wyoming has an effective rate of .75%, and Montana is at about 1.25-1.3%. South Dakota and North Dakota are at 0% because they do not tax business equipment. Washington is 1.19 and New Mexico 1.21. There is a possible effect reflected in the Department of Revenue's worksheets that if the business equipment tax goes to zero in approximately 2007 if the economy does well year after year, then there could be an effect on the centrally assessed property. **REPRESENTATIVE SCHMIDT** asked what she was saying would happen. **Mary Whittinghill** replied it is her understanding these figures reflect the possible reduction could be if all other companies' business equipment would be zero.

REPRESENTATIVE WANZENRIED said Mike Foster testified if there was a slow economy there would be school closures and wanted a comment and explanation. **Mike Foster** said he stated this could occur. **REPRESENTATIVE WANZENRIED** asked if part of the reason for school closures was due to a decrease in the property tax on business equipment. **Mike Foster** said he would not admit that because there is no evidence to indicate this. In each community, factors for school closures are different. In some places school enrollment has dropped, which can cause a school to close or consolidate.

REPRESENTATIVE LASLOVICH asked if assuming this bill did not pass if 2002 would be too late to again bring up this issue. **REPRESENTATIVE ERICKSON** said he is confident this issue will be back in 2003 if this bill does not pass. Whether this is in time in terms of school planning and budgets is not clear.

CHAIRMAN STORY asked if the sponsor would agree assuming the trigger was hit that the tax would not start phasing down until 2004. **REPRESENTATIVE ERICKSON** said he agreed. **CHAIRMAN STORY** asked if the tax was still in place in 2004-2006 if the other dire predictions would not happen. **REPRESENTATIVE ERICKSON** said there are other things happening to the revenue flow as well on the sheet, such as intangibles and the phase out of the livestock tax. There is a major decrease in expected revenue even without the trigger happening much larger than expected two years ago. **CHAIRMAN STORY** asked if livestock and intangibles were disregarded, which neither one are driven by the trigger, the spillover effect of the trigger into other classes of property would probably not be a problem until the zero was reached on business equipment, assuming all the assumptions were believed. **REPRESENTATIVE ERICKSON** said he assumed the question meant, for example, the problem with the pollution control equipment being shifted will not start to occur until the trigger is met. **CHAIRMAN STORY** said most of these assumptions are driven by Class 8 going to zero and then the legal ramifications of similar equipment in other classes. **REPRESENTATIVE ERICKSON** said that is why he wanted to look particularly at tables 3A and 4A but believes 3A is more likely. **CHAIRMAN STORY** asked if it was agreed that assuming the trigger was reached and it goes from 3 to 2% and then from 2 to 1, business equipment would still be taxed and in most likelihood the other types of property would not have that legal basis to ask for relief other than through legislative action. **REPRESENTATIVE ERICKSON** said the chairman was correct, and the $200 million versus would take longer than the $127 million. **CHAIRMAN STORY** asked what caused the increase in wages from 1992 to 1994 on the Raw Data sheet at an almost enormous growth, even after the recession in 1991. **REPRESENTATIVE ERICKSON** said he thought the first year out of a recession a trigger is clearly pulled. **Jim Standard** said there was a recession at the national level in 1991 and 1992, but it was barely felt in Montana. It possibly was the rest of the nation coming out of the recession in those years that helped this. **CHAIRMAN STORY** said the inflation was around 3% in those three years and wages and salaries grew at 6-7%, so he wondered where sector of the industry that growth came from and if there was a method of looking at that. **Jim Standard** said these numbers are pulled from a database, but there are components to these numbers, and he would get that.

Closing by Sponsor:

{Tape : 2; Side : B; Approx. Time Counter : 46.2}

REPRESENTATIVE ERICKSON said there was a reference to telecommunications and how important it would be for them to have a break on business equipment. He had been given a list of what the high-tech industries look for when they decide where they are going: #1 was well trained work force, #2 was access to research facilities, and #7 was possible tax policy. When thinking about economic development, education is the area they will likely be looking at the most. SB 200 failed and finally in a conference committee was worked out and the trigger came to be. None of the data Jim Standard had was shown in the taxation committee or on the floor. $200 million is a large sum, and whatever this economic development is going to do to hit this trigger, there has to be a 35% increase in income to replace the $200 million. None of the opponents showed there was anything wrong with the Department of Revenue's report which show a "precipice." If there was a year with 3% inflation and 6% increase in wages and salaries, the trigger has been hit and it does not matter in years to come. 6% is $13 million of the $200 million needing to be replaced.

ADJOURNMENT

Adjournment: 12:07 P.M.

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REP. BOB STORY, Chairman

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RHONDA VAN METER, Secretary

EXHIBIT(tah09aad)