

MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE SENATE

March 26, 1986

The first meeting of the Senate Taxation Committee was called to order by Chairman Thomas E. Towe at 8:03 am, Wednesday, at the State Capitol.

ROLL CALL: All members of the committee were present.

CONSIDERATION OF SB 8: Senator Fred Van Valkenburg, chief sponsor of the bill, submitted his testimony to the committee in writing (Exhibit 1).

PROPONENTS

Terry Cohea, Executive Assistant to Governor Ted Schwinden, rose in support of SB 8. She discussed the negotiations and resulting settlement that led to the introduction of the bill. She said the goals of the negotiations were to insure a reliable and adequate source of revenue for local governments, to stay as close to the original desire of the committee as possible, and to comply with federal law and be fair to other Montana taxpayers. She then referred to her written testimony found in Exhibit 2. She closed saying that it was not the intent of the Executive to bind the Legislature, but to present an alternative that would be ironclad.

Leo Barry and Stan Kaleczyc appeared as attorneys on behalf of their client, Burlington Northern.

Mr. Barry recounted the rocky history of the relationship between the state and BN. He said that the new agreement was an outgrowth of the attitude of BN's new president and the Governor of Montana. Mr. Barry said that after the principles of the agreement were reached, he had become involved in the negotiation of the agreement itself. He said that while it might not be the best way to set tax policy the set of circumstances involved dictated that it be done this way. He said that the legislation was not presented with a "take it or leave it" attitude, but that it did represent the product of very difficult negotiations. He said that Governor Schwinden had insisted on a signed agreement. He said that many people on both sides were dissatisfied in some respect with the settlement. He noted that the current law was a result of broken negotiations. He said that the Legislature must fully understand the agreement in making the decision. He said that BN had no desire to litigate, but would do so if it became necessary. He said the railroad prefers to put the time of conflict behind and recognize that the state needs BN and BN needs the state.

He then referred to the "BN Statement on Property Tax Settlement" (Exhibit 3) and a summary of BN ad valorem taxes (Exhibit 4) which were distributed to the committee.

Mr. Kalaczyc then addressed other BN issues. He said that whether one thought the state was giving up money was a matter of manipulation of numbers. He said that key to that argument was how the system value of BN was construed. He said BN had agreed to the \$3.5 billion figure used in the settlement, but that if the settlement were not ratified, all bets were off.

Second, he addressed the net and gross proceeds issue. He said that the railroad thinks that these are not properly included in the valuation. He noted that in Arizona and Kansas no net and gross proceeds are used. In Utah net and gross proceeds are not used as part of the commercial and industrial formula. He said that only Montana uses this.

Third, he said that he cannot predict what BN would do, but that the bastardized equalization in HB 240 did not feel comfortable to the railroad.

Fourth, he addressed the question of the tax loss. He said that depended on whether the "retirement, replacement, betterment" (RRB) method were used or the gradual depreciation method were used. He noted that the ICC calls for the gradual depreciation, but that RRB was used for determining a railroad's rate of return. He concluded that the BN would phase in the depreciation method for the agreement, but would not be bound to that outside of the settlement.

Fifth, he said that while other utilities were taxed at the 12% rate, no equalization was required by state or federal law and that the operative laws were simply different. He noted that while ore haulers and trucks are taxed at 16%, the terminals themselves were taxed at 3.6%. He said for purposes of averaging these cannot be isolated.

Sixth, he said that the rail spurs owned by private companies in the state have a different earning power for their owners than BN track has. He said there is often more value to a particular short section.

Seventh, he said that discussion of BN revenue was not appropriate as property tax and not income tax was being discussed.

He concluded saying that the committee should look at the settlement carefully. He said that the railroad is conceding several main points, i.e. the accounting method, the fixed equalization rate and the valuation. He said the Department of Revenue has given up things as well, and that both sides feel they could do better in court. He noted that as the hallmark of a good settlement.

Les Lobel, representing the airlines said that they support the bill with an amendment on page 2, line 1 to drop the small "(a)"

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and put equalization for the airlines on the same footing as that for the railroads. He noted that the sales assessment ratio studies were not a subject of his negotiations with John LaFaver in concluding the airline settlement, but that it does appear in the bill. He said the income loss to the five counties would be \$280,000. He also noted that the negotiations with LaFaver and with Gregg Groepper had been in good faith and above board and he appreciated the attitude of the Department.

Dave Goss submitted testimony representing Jase O. Norsworthy of the Forward Billings Economic Development Council (Exhibit 5). They supported SB 8.

Ben Havedahl of the Montana Motor Carriers said that motor carriers should also be included in the equalization and he wanted to inform the committee that his organization was watching the settlement. He did not support or oppose the bill.

Vice Chairman Mazurek assumed the chair.

OPPONENTS

Senator Thomas Towe spoke in opposition to the bill. He submitted Exhibit 6 to the committee to show that Montana ranks 14 of 15 in taxable value per mile. He said Montana was only 4th of 11 in property tax paid and that other states with less track miles collected more taxes from BN.

He complemented Governor Schwinden on working out the settlement. He said that it was critical how it was handled and that more people should have been involved. He complemented the Department of Revenue for the airlines agreement and said he had no problems with that part of the settlement. He said, however, that the the railroads had just been handed \$40 million over the next years.

Senator Towe submitted Fact Sheet #3 (Exhibit 7) and Fact Sheet #4 (Exhibit 8). He noted that the Fiscal Note on the bill noted an even greater loss than he had predicted. He said that the ICC did not find the betterment depreciation method realistic. He said that Fact Sheet #3 contained the effective Fiscal Note for the bill. He said that the bill represented not a settlement but a "give away".

Referring to Fact Sheet #4, Senator Towe said that the effective rate was 7.2% if betterment depreciation was figured in. He said that airlines have already agreed to 12% and that of course utilities and trucks would come in also wanting the lower rate.

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Senator Towe said that he did not believe that the legal risk led to the settlement. He reminded the committee that BN had worked for two years with the Revenue Oversight Committee to develop SB 48. He discussed a May 10, 1985, memo from James Oppedahl to Terry Cohea stating that four states have used mineral valuations in their formulas. He said that Arkansas, Kansas, Utah, and Arizona all include net and gross proceeds.

He noted for the committee that BN is an exceedingly wealthy company with an income that increased three times between 1982 and 1984. He said their profits were up 18% in the last quarter of 1985 over 1984. He said it would be difficult to justify giving this settlement to one of the most profitable corporations in American and expect our farmers and businesspeople to make up the difference. He said the settlement would mean that BN would pay less taxes than MPC who makes half of BN's income in the state.

He questioned the discrimination against the airlines in the bill.

He noted that the case heard by Judge Battin was biased by ruling that value was untouchable. He noted also that no one else gets a valuation factor in 1986.

Mr. Phil Campbell of the Montana Education Association also rose in opposition to SB 8. He cited the MEA concern that funding for schools would be cut. He said that citizens are already taxed the maximum to support schools. He estimated a \$20 to 30 million loss to Montana schools with passage of the bill. He said the Fiscal Note reflected only the Foundation Program loss, so that the actual loss would be greater and that a significant part of it would be incurred in the first year.

Mr. Bob Mullen, President of the Montana Association of Counties said that they opposed SB 8. He said with the uncertainty faced with federal cut backs, the loss of crops in storage to the taxing rolls, that they were concerned with further erosion of the tax receipts of counties.

Chairman Towe resumed the chair and opened the consideration to the committee for questions.

Senator Lybeck asked if it was reasonable and fair that the 1985 Legislature commit a future Legislature and Executive beyond the two years. Senator Van Valkenburg said this was no different than any other law. He said that the law could be changed, but that then BN would not be bound by the agreement. He noted that only litigation is binding. He said it is frustrating to have the Legislature subserviant to the courts. He said that the settlement is in the best interest of the state as its bipartisan support demonstrates.

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Senator Goodover questioned the termination date. Senator Van Valkenburg said he was only willing to legislate as far as the agreement reaches. He said this is what keeps the Legislature in a negotiating position.

Senator Goodover asked if the original HB 240 could be brought back.

Senator Brown asked about the curiosity of the equalization rate amount agreeing exactly with the figures in SB 48. Ms. Cohea said that was the anchor in the negotiation below which the state would not go.

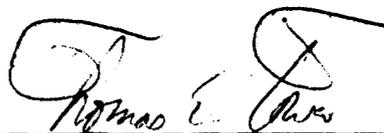
Senator Brown said that the 12% seemed like a facade and that the equalization rate was arrived at to allow the railroads to pay what they were willing to pay. Ms. Cohea responded that it was drafted to reflect 12% as a desire and the 4R act as a fact.

Senator Eck asked if market value was fixed. Ms. Cohea said that the projections don't account for an increase in value, but that as value increased it would be taxed.

Senator Eck asked about BN willingness to use a sales assessment ratio. Mr. Gregg Groepper of the Department of Revenue was recognized and said that no numbers are now available. He said that the tax rolls are already four years out of date and that such a study would have to be completed this year if it were to be done.

Chairman Towe recognized Senator Van Valkenburg for his closing comments. Senator Van Valkenburg said that the main point was that this was a very complex issue. He said that it cannot be painted in black and white. He said the bill would avoid expensive litigation. He said the case of comparison to other taxpayers should be argued in Congress. He said that this represents a real opportunity to settle the dispute now and that a change in the tax protest law would not handle the problem as it could not be applied to a railroad.

Chairman Towe adjourned the hearing at 10:02 am.



Chairman Thomas E. Towe

Senate Taxation Committee

ROLL CALL VOTE

Date 26 March 86

Bill No. _____

Motion: Attendance

	YES	NO
Senator Brown	✓	
Senator Eck	✓	
Senator Goodover	✓	
Senator Hager	✓	
Senator Halligan	✓	
Senator Hirsch	✓	
Senator Lybeck	✓	
Senator McCallum	✓	
Senator Neuman	✓	
Senator Severson	✓	
Senator Mazurek	✓	
Chairman Towe	✓	

TESTIMONY ON SB 8
SUBMITTED TO SENATE TAXATION COMMITTEE

Senator Fred Van Valkenburg

March 26, 1986

I. Explanation of the bill.

A. Puts into law, for the next six years, a formula for taxing federally protected railroad and airline property in Montana. This formula has been established pursuant to lengthy, heated, complex but mutually fruitful negotiations between the State of Montana and the major federally protected transportation companies operating within our state.

B. At the end of this 6-year period, the law reverts to its exact form prior to negotiations.

C. With respect to airline property, the bill establishes a tax rate of a flat rate of 12% during this 6-year time period. Because the negotiated agreement with the state's major airlines is only for a 5-year period, the last year's taxes will be subject to protest unless an extension is agreed to.

D. With respect to railroad property, the bill establishes a 12% tax rate for the next 6-year period which is subject to an equalization factor of 70% in the 1st year and 75% in each succeeding year. As a result the effective tax rate as applied to railroads is 8.4% in FY 87 and 9.0% in each succeeding year.

E. Mechanically, the tax rate for tax years 1986 through 1991 is set out on line 22; the equalization factor applied to railroads during this same period is set out in lines 23-25 page 1, and line 1 of page 2. Current law is amended on pages 2 and 3 to delay its application until tax year 1992.

II. Effective Tax Rate

Others will explain in detail why the effective tax rate is established at 9.0%. Let me say though that my own analysis is that this figure is very close to the 4R's act legal requirement of the average of all commercial and industry property in the state. Of course some property is taxed at 16% and major utilities are taxed at 12%. But you surely know that main street businesses are taxed at 3.86% and new industrial property at 3%. These all have to be averaged together. It only makes sense that you're going to end up with an average under 12%. The 9% figure is obviously open to debate but given the BN concessions on other factors in the formula (i.e., valuation, accounting method, inclusion of net and gross proceeds), it is a reasonable and defensible figure.

III. Reason for Introduction

Railroad taxation in Montana has resulted in substantial controversy in this state for at least the last seven years. HB 240 of the 1985 session, the most recent effort, passed the Legislature amidst a barrage of political, economic, and legal attacks. It is argued by some that its passage resulted in the loss of hundreds of jobs in Livingston. Some argue that its continued existence threatens many more jobs. The railroad, to its credit, has denied any connection between the bill and the Livingston shop closure. Most of us don't believe there is a direct connection. Surely though, we know the railroad is extremely unhappy with HB 240, that it will challenge the imposition of property taxes in Federal Court later this year. We also know

that no change in the current law will result in very tenuous if not hostile relations between the railroad and the State of Montana. Hostile relations certainly existed as recently as 2 months ago as I'm sure Terry Cohea will tell you when she testifies. Fortunately, much cooler and wiser heads have prevailed both in the railroad and state government.

The negotiated agreement before you may not be the one you would have negotiated on the state's behalf or even one you like very much. However, I believe it reflects the best agreement either party could hope to achieve under the circumstances.

This agreement will result in a minimum of a 20 percent increase in BN's property taxes this year. Those taxes will increase in each of the next 5 years. Those taxes can be counted on by local governments and school districts in a time when those entities will be going through some of their most difficult budgeting sessions due to federal and state cuts and other negative influences.

Some will argue that those entities can get more money, can avoid the uncertainties resulting from current tax protest provisions, and that no harm will come to the citizens of this state if this bill is rejected. I disagree. Let me point to a couple of significant dollar differences. The Chairman has distributed a fact sheet. For the purposes of calculation it assumes an average mill levy of 248.417 mills. The fiscal note to SB 8 and the negotiations between the Governor and the BN assumed an average mill levy of 240 mills. This alone results in a \$3.3 million difference in estimating revenue foregone. In addition the fact

Senator VanValkenburg Testimony on SB 8
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sheet makes numerous assumptions about such factors as valuation, accounting methods and legal conclusions (i.e., that the inclusion of net and gross proceeds taxes in the current formula is the only area where the state is vulnerable in a lawsuit). Others will detail this more, but in short, the critics of this bill understate the state's risk in litigation and overstate the financial gains associated with current law if it is upheld.

Some are upset because they think the Governor should not negotiate the state's tax policy. I disagree. Whenever expensive, lengthy and risky litigation is a possibility, the parties should negotiate. The Governor is the chief executive officer of this state. He has the trust of the people of this state. I doubt seriously that the 72% of the people of this state who elected him believe that he would sell the state down the river to the BN. It's not very realistic to think that the BN is going to sit down with 150 legislators and negotiate. The BN believes it can win in court. It has won in court as recently as 1982.

Nevertheless, if you want to try and work out a better deal you can still do it between now and the time this agreement expires in 1991. More so, because of changes I have made, you maintain the same negotiating stance you presently have.

Finally, I want to address an issue which may have more to do with the outcome of this bill and our state's future than anything else. We cannot ignore our state's history. The spectre of corporate domination will not soon nor should it be forgotten. However, we can't live in the past. We must live not only for today, but 10 and 20 years from today. The BN is not the Anaconda

Exhibit 1--SB 8
MAR 26, 1986

Co. Big is not bad in and of itself. We have an obligation to prevent the kind of corporate domination that existed in years gone by. But we also have an obligation to treat Montana's largest employer fairly.

The average Montanan may not fully comprehend this yet, but I think you do.

The average Montanan knows very little about the 4R's act and the problems it causes regarding taxation of the BN but I think you do.

The average Montanan doesn't know that the passage of this bill will result in a 20% increase in BN's taxes over last year and over a 100% increase over BN's average annual taxes for the last 10 years, but you should know that.

The average Montanan may not know these things now, but he or she is smart enough to figure them out in the not too distant future. You should know that.

Please give this bill a chance. It's a bi-partisan effort to make peace with the BN and airlines, to provide a stable revenue base to local governments and school districts, protect the Legislature's right to establish tax policy and start down a new road for a better Montana.

GOVERNOR'S PROPOSAL REGARDING PROPERTY TAXATION
OF AIRLINES AND RAILROADS

INCREASED REVENUE FOR LOCAL GOVERNMENTS AND SCHOOLS

The Governor's proposal would increase railroad taxes in 1986 by more than 20% above the current level:

Property Tax Paid on Montana Portion of BN System

1979	\$4.4 million	1983	\$5.3 million
1980	4.0 million	1984	8.2 million
1981	4.6 million	1985	8.8 million
1982	4.4 million	1986	10.6 million (with proposed legislation)*

The proposal also provides for an annual increase over the next five years, as the Department of Revenue phases in a new valuation method:

1987	\$10.9 million*	1990	\$11.8 million*
1988	11.2 million*	1991	12.1 million*
1989	11.5 million*		

The proposal would also settle the four-year litigation concerning airline taxation and provide seven counties \$2.98 million in tax funds (most of which was under protest) this year:

<u>County</u>	<u>Amount</u>
Silver Bow	\$227,752
Cascade	\$595,346
Yellowstone	\$903,861
Missoula	\$389,134
Lewis & Clark	\$371,307
Gallatin	\$382,230
Flathead	\$113,036

TAX PROTESTS AND LITIGATION AVOIDED

If the Governor's proposal is adopted, the railroads would agree not to challenge the tax rate or method for the next six years and the airlines for the next five. This will insure a reliable revenue source for local governments and schools for the rest of this decade.

Litigation is costly for both the state and local governments. The state spent over \$250,000 during the past five years' litigation over railroad tax issues, and local governments had over \$30 million tied up in tax protest accounts for over four years.

* Tax paid on current system value, adjusted for phased-in new valuation method, at current mills. These figures would be adjusted to reflect increases or decreases in system value (income, stock and debt, and cost).

A FAIR TAX RATE

Railroad and airlines would continue to be taxed based on a formula-derived average rate applied to other commercial and industrial property (including net and gross proceeds). The proposal provides, however, that the formula-derived rate may not exceed or fall below 12%, the rate for other centrally assessed property such as the telephone company and the power company.

The proposal would assure that the tax rate would not exceed 12%. HB 240 (the bill passed last session) contains a mechanism that will, with current estimates, create a declining tax rate for railroads and airlines over the next five years (from approximately 14% in 1986 to about 11.4% in 1990).

This proposal taxes all the property involved in railroad or airlines system (rolling stock, warehouses, docks, buildings, tracks, planes) at 12%. While large trucks are taxed at 16% under current law, the real property involved in trucking operations (such as loading docks, warehouses, buildings) is taxed at 3.86%.

The Governor's proposal does not affect the tax rates for any other types of property. The proposal does not suggest that residential and commercial property be placed in different classes.

Submitted by



TERESA OLCOTT COHEA
March 21, 1986

BURLINGTON NORTHERN RAILROAD

WAYNE A. HATTON
Vice President - Billings Region

600 Norwest Bank Center
175 North 27th Street
Billings, Montana 59101

March 21, 1986

Governor Ted Schwinden
Governor's Office
Capitol Station
Helena, MT 59620

Dear Governor Schwinden:

I am pleased to relate Burlington Northern Railroad's support for legislation you will propose to remedy the pending dispute over our property tax liability in Montana.

It is our understanding that you will propose to amend the current law so as to impose a 12% classification rate upon railroad property. The precise implementation and administration of this agreement depends upon a memorandum of understanding which has been developed between Burlington Northern and the Montana Department of Revenue. Burlington Northern Railroad will not challenge the imposition of these taxes so long as they are levied in accord with this understanding.

We believe this agreement will avoid costly and protracted litigation and ensure a predictable source of revenue to local governments and school districts for the next several years. Should the formula contained in the agreement produce a tax liability in 1986 of less than \$10.6 million, Burlington Northern Railroad, nevertheless, agrees to pay \$10.6 million in Montana ad valorem taxes in 1986.

Sincerely,



Wayne Hatton
Regional Vice President

*Exhibit 2 - S.B. 8
March 26, 1986*

Union Pacific Corporation



March 19, 1986

Honorable Ted Schwinden
Governor of Montana
State Capitol, Room 204
Helena, Montana 59620

RE: Railroad Property Taxation and Equalization of Rates

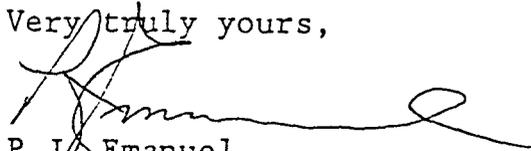
Dear Governor and Legislative Leaders:

Union Pacific Railroad Company understands that a special session of the Montana Legislature will consider railroad property taxation and compliance with the provision of the Railroad Revitalization and Regulatory Reform Act of 1976 (the 4-R Act) prohibiting discriminatory taxation of railroad property. Union Pacific is supportive of efforts to move toward reconciliation of Montana's property tax system with the 4-R Act.

We have been advised that the special session will consider legislation amending the classification ratio of railroad property to 12%. We believe this would constitute a positive effort and such an effort has Union Pacific's endorsement.

We shall follow the progress of the special session with interest.

Very truly yours,



P.J. Emanuel
General Manager - Transportation Property Taxes



F. K. Kalb
Senior Tax Counsel - State and Local

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AGREEMENT BETWEEN
BURLINGTON NORTHERN RAILROAD
AND
THE STATE OF MONTANA

WHEREAS, Burlington Northern Railroad is entitled to nondiscriminatory treatment for tax purposes in the State of Montana pursuant to Section 306 of the Railroad Revitalization and Regulatory Reform Act (49 U.S.C. § 11503) (4-R Act); and

WHEREAS, the State of Montana enacted legislation in 1985 concerning the ad valorem taxation of railroad property (Chapter 743 of the Laws of the 49th Session of the Montana Legislature) (1985 legislation); and

WHEREAS, Burlington Northern Railroad believes that the 1985 legislation does not comply with provisions of Section 306 of the 4-R Act; and

WHEREAS, the implementation of the 1985 legislation would result in a significant increase in Burlington Northern Railroad's property tax liability; and

WHEREAS, Burlington Northern Railroad in pursuing its legal remedies concerning the issues at dispute can challenge the 1985 legislation and in so doing could protest significant amounts of its property taxes; and

WHEREAS, the State of Montana and Burlington Northern Railroad desire to provide a stable and reliable revenue source for local governments and school districts; and

J.B.8
Exhibit 2
MAR 26, 1986

WHEREAS, the State of Montana and Burlington Northern Railroad desire to resolve the property tax dispute so that they can continue to move forward to develop a positive working relationship in the future.

NOW THEREFORE, Burlington Northern Railroad (BNRR) and the State of Montana (State), referred to herein collectively as the "parties", agree as follows:

1. This Agreement is premised upon the parties' Agreement in principle that, subject to the terms and conditions contained in this Agreement, BNRR would, for the tax years commencing January 1, 1986, and ending December 31, 1991, pay ad valorem taxes in the State of Montana without protest subject to the provisions of this Agreement. The Agreement is premised upon a valuation methodology which when applied to 1985 BNRR reports arrives at a unitary system value of \$3.5 billion, with approximately 14.13% of that system value apportioned to the State of Montana. The Agreement is further premised upon an annual change in BNRR's taxable value directly attributable to the phasing in, for purposes of the Agreement, a system of accounting known as depreciation accounting during the term of this Agreement. In the event that the unitary system value or the apportioned value of that system changes during the term of this Agreement as a result of changes to the income, stock and debt, or cost attributable to

*Exhibit 2-V.B.8
March 26, 1986*

the operations of BNRR, or to the statistics used in the determination of the apportioned system value, then the taxable value of BNRR will be adjusted based upon such changes.

2. This Agreement is further premised upon the enactment of legislation during the Special Session of the 49th Montana Legislature convening March 24, 1986, which provides: (a) that the tax rate imposed upon railroad property for ad valorem taxation purposes pursuant to § 15-6-145, MCA, or any successor section thereto, shall not exceed 12.0%; and (b) that in lieu of a sales assessment ratio study, the Montana Department of Revenue in determining taxable value shall multiply the tax rate established in § 15-6-145, MCA, by 70% for tax year 1986, and by 75% for tax years 1987 through 1991, inclusive. In the event that the aforescribed legislation is not enacted into law, this Agreement shall be null and void in its entirety, and shall have no effect. In such event, the parties agree to enter into further good faith negotiations to attempt to resolve the property tax dispute between the parties. It is expressly agreed and understood that during such period of further negotiations neither party shall be foreclosed from pursuing any legal rights or remedies which it may have with respect to the issue of the imposition of ad valorem taxes.

3. This Agreement shall apply only to the taxable years commencing January 1, 1986, and ending December 31, 1991, which x years shall be collectively referred to herein as the "settlement period".

4. The State of Montana may, solely for purposes of this Agreement in determining the unitary system value of BNRR during the settlement period, consider the influence of a change in accounting methods commonly referred to as depreciation accounting as identified in Interstate Commerce Commission Order No. 36988, using the following procedures.

a. For any given tax year covered by the Agreement, the State of Montana will calculate pursuant to paragraph 6, two system values; one utilizing the accounting method referred to as retirement, replacement, and betterment accounting as used in 1985 and referenced in paragraph 6 and one utilizing the accounting method referred to as depreciation accounting, holding all other factors constant in the determination of value.

b. Any change in the system value of BNRR attributable to the influence of depreciation accounting valuation method shall be phased in during the life of this Agreement at a rate not to exceed 20% a year in accordance with the following schedule:

(1) Year 1987 - 20% of the difference between the two methods.

(2) Year 1988 - 40% of the difference between the two methods.

(3) Year 1989 - 50% of the difference between the two methods.

(4) Year 1990 - 80% of the difference between the two methods.

(5) Year 1991 - 100% of the difference between the two methods.

5. BNRR shall during the settlement period pay taxes on Class 15 property as currently defined in § 15-6-145, MCA, based upon a percentage rate of exactly 12%, and shall not protest during the settlement period any amount of taxable value for such property determined under the terms of this Agreement.

6. The State will value the operating property of BNRR for ad valorem tax purposes using the system of valuation which is commonly referred to as the unit valuation method. Except for the provisions outlined in Paragraph 4 of this Agreement, the State will compute value under this system by using three approaches. They are: (a) the cost approach, (b) the income approach, and (c) the stock and debt approach. The detailed methodology including allocation, shall be as set forth in the accompanying worksheets which show the computation for the 1981 tax year and which are incorporated by reference. It is understood and agreed that BNRR shall at its own expense annually obtain the opinion of investment bankers, Morgan Stanley and

tax year and which are incorporated by reference. It is understood and agreed that BNRR shall at its own expense annually obtain the opinion of investment bankers, Morgan Stanley and Company, as to the value of Burlington Northern, Inc., stock which is attributable to nonrailroad activities of the company. The State will use such opinion in determining the nonoperating property deduction under the stock and debt approach. The State reserves the right to approve the use of Morgan Stanley and Company; however, the State may not act unreasonably in its approval process. In any litigation contesting a disapproval, neither party has the burden of proof. If BNRR should wish to utilize the services of a different investment banker than an investment banker satisfactory to the State will be chosen.

7. In lieu of a sales assessment ratio study as a factor in determining equalization, the parties agree that the Montana Department of Revenue in determining taxable value shall multiply the tax rate established in § 13-6-145, MCA, by 70% for the 1986 tax year and by 75% for each of the tax years 1987 through 1991 inclusive.

8. BNRR agrees not to challenge the phased utilization of the depreciation accounting method or the inclusion of gross and net proceeds within the tax classification rate calculation contained in § 15-6-145, MCA, during the settlement period. The Agreement not to initiate such a challenge during the settlement

S.B.8
Exhibit 2
Mar 26, 1986

period does not constitute an admission by BNRR that such accounting method or the inclusion of gross and net proceeds is proper or lawful, or that BNRR concedes that the taxing method prescribed by Chapter 743 of the Laws of the 49th Session of the Montana Legislature is proper or lawful; and BNRR expressly reserves the right to challenge the use of the depreciation accounting method, the inclusion of gross or net proceeds, or any other taxing or valuation method prescribed by Montana statute, administrative regulation, or other action of the Montana Department of Revenue after the expiration of the settlement period.

9. The parties intend this Agreement to settle a property tax dispute unique to Montana and BNRR's position in Montana. This Agreement will not affect possible tax disputes between the parties resulting from classifying property in a different tax class. Should such a dispute arise, BNRR agrees only to protest the value increase as a result of this reclassification. This Agreement is not intended to be used by any other parties for any reason or purpose whatever. The Agreement is intended to be legally binding on the parties and enforceable in a court of competent jurisdiction and may be entered into evidence for that purpose. Except as otherwise provided herein, so long as both parties abide by the terms of this Agreement, neither party during the settlement period may utilize any administrative proceedings, tax appeals, or litigation concerning the

classification, equalization or valuation of BNRR property for ad
valorem tax purposes in Montana.

DATED this ____ day of March, 1986.

BURLINGTON NORTHERN RAILROAD

By: 

STATE OF MONTANA

By: _____

APPROVED FOR LEGAL CONTENT:

By: _____

ilb/90

1 IN THE DISTRICT COURT OF THE FIRST JUDICIAL DISTRICT OF THE
2 STATE OF MONTANA, IN AND FOR THE COUNTY OF LEWIS AND CLARK

3 -----
4 NORTHWEST AIRLINES, INC., WESTERN)
5 AIR LINES, INC., FRONTIER)
6 AIRLINES, INC., AND UNITED AIR)
7 LINES, INC.)

8 Plaintiffs,)

9 -vs-)

10 SILVER BOW COUNTY AND THE TREASURER)
11 THEREOF, JAMES C. DAVIS; CASCADE)
12 COUNTY AND THE TREASURER THEREOF,)
13 RICHARD J. MICHELOTTI; YELLOWSTONE)
14 COUNTY AND THE TREASURER THEREOF,)
15 MAY JENKINS; MISSOULA COUNTY AND)
16 THE TREASURER THEREOF, FERN HART;)
17 LEWIS AND CLARK COUNTY AND THE)
18 TREASURER THEREOF, MARTHA B. MCGEE;)
19 GALLATIN COUNTY AND THE TREASURER)
20 THEREOF, LOY R. CARROLL; FLATHEAD)
21 COUNTY AND THE TREASURER THEREOF,)
22 IDELLA SMITHERS; DEPARTMENT OF)
23 REVENUE OF THE STATE OF MONTANA;)
24 STATE TAX APPEAL BOARD OF THE)
25 STATE OF MONTANA; MARY E.)
HEMPLEMAN, ROBERT S. RAUNDAL and)
DALE DEAN, as members of and con-)
stituting the State Tax Appeal)
Board of the State of Montana,)

Defendants.)

SETTLEMENT AGREEMENT

22 WHEREAS, Northwest Airlines, Inc., Western Air
23 Lines, Inc., Frontier Airlines, Inc., and United Air
24 Lines, Inc., ("Airlines") have filed lawsuits for the
25 years 1982 through 1985 challenging the taxation of the

1 Airlines under Section 532 of the Tax Equity and Fiscal
2 Responsibility Act of 1982 (TEFRA), and

3 WHEREAS, the Airlines have likewise filed lawsuits
4 pertaining to the allocation of the unit value of the
5 Airlines to the State of Montana for taxation purposes,
6 and

7 WHEREAS, the Airlines and the State of Montana,
8 Department of Revenue ("State") wish to settle their
9 differences, end the litigation and

10 WHEREAS, all of the parties wish to agree on the
11 amount of tax relief which results to the Airlines on
12 account of TEFRA and wish to agree on methodologies for
13 determining the system value of each airline and alloca-
14 tion of Montana's share of that system value to Montana
15 for taxation purposes, and

16 WHEREAS, the parties desire that this agreement
17 continue for the next reappraisal cycle,

18 NOW, THEREFORE, the Airlines, the State, and the
19 Treasurers of the counties named in paragraph 1 below
20 ("Treasurers") in consideration for the tax refunds to
21 be made and for the mutual promises and covenants
22 contained herein, agree as follows:

23 W I T N E S S E T H:

24 1. As provided in paragraph 11 below, the Air-
25 lines shall cause each and every complaint which is on

1 file in Yellowstone County, Lewis and Clark County,
2 Flathead County, Silver Bow County, Cascade County,
3 Gallatin County and Missoula County, which seeks relief
4 from the State and the Treasurers under Section 532 of
5 the Tax Equity and Fiscal Responsibility Act of 1982
6 (TEFRA) and which relates to tax years 1982, 1983, 1984,
7 and 1985, to be dismissed with prejudice as fully
8 settled upon its merits.

9 2. As provided in paragraph 11 below, the Air-
10 lines shall cause each and every complaint which is on
11 file in Yellowstone County, Lewis and Clark County,
12 Flathead County, Silver Bow County, Cascade County,
13 Gallatin County and Missoula County, which seeks relief
14 from the State and the Treasurers for an alleged improv-
15 er allocation of a portion of the system value of each
16 Airline to the State of Montana for purpose of ad
17 valorem taxation to be dismissed for the tax years 1983,
18 1984 and 1985 to be dismissed as fully settled upon its
19 merits.

20 3. If the Montana legislature during the 1986
21 special session presently scheduled to begin March 24,
22 1986 passes legislation which places a cap of 12% upon
23 the tax rate applicable to the Airlines specified in
24 Section 15-6-145, MCA, then it is agreed that the tax
25 rate for the Airlines shall be 12% during the settlement

1 period notwithstanding any legislative changes during
2 the settlement period. If the legislature fails to
3 place a cap of 12% then the parties are left to their
4 legal remedies as to the appropriate tax rate which they
5 would have had in the absence of this agreement.

6 "Settlement period" is defined as the next five-year
7 reappraisal cycle, that is, tax years 1986, 1987, 1988,
8 1989 and 1990; if the reappraisal cycle is extended by
9 the legislature then the "settlement period" shall
10 continue through any such extension.

11 4. Subject to the qualifications stated in
12 paragraph 6 below:

13 (a) the parties are agreed that the net
14 proceeds tax which is set forth in Section 15-6-131,
15 MCA, is a property tax;

16 (b) the parties are agreed that Class 1
17 property, which is subject to taxation under Section
18 15-6-131, MCA, is a type of commercial and industrial
19 property within the meaning of Section 532 of TEFRA;

20 (c) for each of the tax years at issue, it is
21 agreed that net proceeds of mines were assessed at 100%
22 of annual net proceeds and that net proceeds of mines
23 were taxed at 100% of annual net proceeds.

24 5. Subject to the qualifications set forth in
25 paragraph 6:

1 (a) the parties are agreed that the gross
2 proceeds tax which is set forth in Section 15-6-132,
3 MCA, is a property tax;

4 (b) the parties are agreed that the Class 2
5 property, which is subject to taxation under Section
6 15-6-132, MCA, is a type of commercial and industrial
7 property within the meaning of Section 532 of TEFRA;

8 (c) for each of the tax years at issue, it is
9 agreed that the gross proceeds of mines were assessed at
10 100% of annual gross proceeds and that the gross pro-
11 ceeds of mines were taxed at the rate set forth in
12 Section 15-6-132, MCA.

13 6. The parties further agree that the agreements
14 stated in the immediately two preceding paragraphs 4 and
15 5

16 (a) are made for purposes of settlement only;
17 they may be entered into evidence to enforce the terms
18 of this agreement or in litigation relative to the
19 property taxes which the State may impose under TEFRA
20 during the settlement period; otherwise they may not be
21 entered into evidence for any purpose in any litigation
22 between the Airlines and the State or between the
23 Airlines and any party in any court of state or federal
24 jurisdiction;
25



1 (b) are limited to and applicable to Montana
2 only and are limited to and applicable to the relations
3 between the parties in Montana only and not applicable
4 to the Airlines and any other parties in any other
5 jurisdiction;

6 (c) are effective for the settlement period
7 only; upon termination of the settlement period the
8 agreements in the two immediately preceding paragraphs 4
9 and 5 are null, void, and of no effect as if they had
10 never been made;

11 (d) are contingent upon, and subject to, the
12 condition subsequent that the Montana legislature (in
13 the 1986 special session presently scheduled to begin
14 March 24, 1986) shall pass legislation which places a
15 cap of 12% upon the tax rate applicable to the Airlines
16 specified in Section 15-6-145, MCA; in the event this
17 contingency and condition subsequent is not fulfilled,
18 then the agreements in the immediately two preceding
19 paragraphs 4 and 5 shall be null, void and without
20 effect as if the same had never been made.

21 7. The parties agree that the lawsuits filed by
22 the Airlines for recovery of taxes either under Section
23 532 of TEFRA or by reason of allegations of improper
24 allocation of a portion of the system or unitary value
25 to Montana of each Airline shall be settled by a

1 reduction of assessment and by a refund of taxes paid
2 during the years 1982 through 1985 as follows:

3 (a) For Northwest Airlines, Inc. there shall
4 be a reduction of its assessment in all counties of 40%
5 for the tax years 1982 through 1985 and the Treasurers
6 shall refund 40% of taxes paid for 1982 through the
7 first half of 1985 and there shall be a 40% reduction of
8 the taxes to be paid for the second half of 1985.

9 (b) For Western Air Lines, Inc. and Frontier
10 Airlines, Inc. there shall be a reduction in its assess-
11 ment in all counties of 20% for the tax years 1982
12 through 1985 and the Treasurers shall refund 20% of
13 taxes paid for 1982 through the first half of 1985 and
14 there shall be a 20% reduction of the taxes to be paid
15 for the second half of 1985.

16 (c) For United Air Lines, Inc. there shall be
17 a reduction of its assessment in all counties of 20% for
18 the tax year 1985 and the Treasurers shall refund 20% of
19 taxes paid for the first half of 1985 and there shall be
20 a 20% reduction of the taxes to be paid for the second
21 half of 1985.

22 (d) All refunds shall be made according to
23 Section 15-1-402(8)(b), MCA: with interest at the rate
24 currently paid on short-term interest-bearing time
25 deposits in banks in the county or 5% a year, whichever

1 is the greater, from the date of payment by the Airlines
2 to the date of refund to the Airlines.

3 (e) The amount of taxes, the counties in
4 which taxes were paid by each Airline and the dates paid
5 are shown on Exhibit 1.

6 8. After the system values of the Airlines are
7 determined pursuant to paragraphs 9 and 10 hereof, a
8 portion of the system value will be allocated to Montana
9 by multiplying the system value by a ratio calculated
10 according to the allocation methodology used by the
11 State in tax year 1985 for each airline. 1985
12 allocation worksheets for each airline are attached as
13 Exhibit 2. Exhibit 2 together with returns as filed by
14 the Airlines demonstrate the methodology. However, in
15 the case of Northwest and Western, instead of using the
16 mobile factor shown on Exhibit 2, the mobile factor
17 shall be the arithmetic average of the ratios defined in
18 subparagraphs (1) and (2):

19 (1) The ratio produced by dividing (A)
20 the total time in plane hours equated by average origi-
21 nal cost of all aircraft of Northwest or Western in
22 flight within this State or on the ground within this
23 State by (B) the total time in plane hours equated by
24 average original cost of all aircraft of Northwest or
25



1 Western in flight or on the ground within and without
2 this State.

3 (2) The ratio produced by dividing (A)
4 all tons enplaned and deplaned within Montana by North-
5 west or Western (B) all tons enplaned and deplaned
6 within and without Montana by Northwest or Western.

7 9. Determination of system value: On or before
8 February 15th of each year of the settlement period, the
9 State shall forward to the Airlines a methodology
10 proposed to be used for the determination of system
11 value for that tax year ("proposed methodology"). Each
12 Airline shall file its return as per the requirements of
13 Section 15-23-103, MCA. Two calculations of system
14 value for each Airline shall be made. The first shall
15 be made according to the proposed methodology. The
16 second calculation shall be made according to the "1985
17 methodology" which is the weighted average of: (1) net
18 book value -- 50% weighting, (2) capitalized income --
19 40% weighting, and (3) stock and debt -- 10% weighting.
20 This methodology is referred to herein as the "1985
21 methodology" because it is the methodology used by the
22 State for the tax year 1985. The capitalization rate of
23 the 1985 methodology will be calculated each year
24 according to Exhibit 3 hereto. In the event a question
25 arises regarding the calculation of system value which

1 is not answered in this paragraph or paragraph 10, then
2 the 1985 methodology will be that shown on the State's
3 work papers which use information provided by the
4 Airlines on their property tax returns for tax year
5 1985. For tax year 1986 a proposed methodology shall be
6 provided on or before March 31, 1986 and the reports of
7 the Airlines shall be due within 30 days thereafter.

8 10. The system value shall be calculated using the
9 1985 methodology and a proposed methodology. The system
10 value used for taxation purposes each year of the
11 settlement period shall be the valuation resulting from
12 a proposed methodology with the following limitation: if
13 the system value resulting from the proposed methodology
14 is 10% greater than the system value resulting from the
15 1985 methodology, the increase shall be limited to 10%
16 for that tax year. These comparisons will be made each
17 tax year using the current tax year information during
18 the entire settlement period and the system value
19 resulting from the proposed methodology shall be used
20 subject to the limitation that if it produces a system
21 value of more than 10% above the valuation resulting
22 from using the 1985 methodology and applied to the
23 current tax year information then the system value shall
24 be that resulting from the 1985 methodology plus 10%.
25

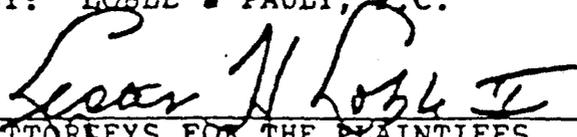
1 11. When the lawsuits required to be dismissed
2 under this settlement agreement are dismissed with
3 prejudice, each party shall bear their own costs. No
4 dismissal of any lawsuit will take place until such time
5 as payment has been made to the Airlines of all amounts
6 required to be made under this settlement agreement and
7 until such time as the District Court has approved this
8 settlement agreement. All appeals pending before the
9 State Tax Appeal Board shall be dismissed according to
10 the same terms and conditions as the court cases.

11 12. Since one of the purposes of this agreement is
12 to avoid administrative proceedings, tax appeals and
13 litigation, so long as each party to this agreement
14 abides by it, no party may resort to administrative
15 proceedings of any sort, tax appeals or litigation on
16 the property tax subjects of system value, allocation of
17 system value to Montana or the property tax rate of 12%
18 (except in the case concerning the tax rate the parties
19 shall be left to their remedies if the legislature fails
20 to pass the 12% cap as provided in paragraph 3).

1 13. This agreement may be executed in counterparts
2 and is effective March 10, 1986.
3

4 NORTHWEST AIRLINES, INC.
5 WESTERN AIR LINES, INC.
6 FRONTIER AIRLINES, INC.
7 UNITED AIR LINES, INC.

8 BY: LOBLE & PAULY, P.C.

9 
10 _____
11 ATTORNEYS FOR THE PLAINTIFFS

12 833 North Last Chance Gulch
13 P. O. Box 176
14 Helena, MT 59624-0176

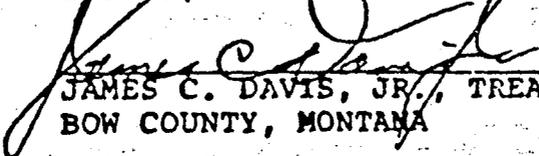
15 STATE OF MONTANA
16 DEPARTMENT OF REVENUE

17 BY: 
18 _____
19 JOHN D. LaFAVER, DIRECTOR

20 
21 _____
22 MAY JENKINS, TREASURER, YELLOWSTONE
23 COUNTY, MONTANA

24 
25 _____
26 MARTHA B. MCGEE, TREASURER, LEWIS AND
27 CLARK COUNTY, MONTANA

28 
29 _____
30 IDELLA SMITHERS, TREASURER, FLATHEAD
31 COUNTY, MONTANA

32 
33 _____
34 JAMES C. DAVIS, JR., TREASURER, SILVER
35 BOW COUNTY, MONTANA

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Richard F. Michelotti
RICHARD F. MICHELOTTI, TREASURER,
CASCADE COUNTY, MONTANA

Loy W. Carroll
LOY W. CARROLL, TREASURER, GALLATIN
COUNTY, MONTANA

Fern Hart
FERN HART, TREASURER, MISSOULA COUNTY,
MONTANA

APPROVED AS TO FORM AND CONTENT:

William M. Woodgum
Counsel
Department of Revenue
Helena, MT
Attorney for the Defendants

	First Half 1982	Second Half 1982	First Half 1983	Second Half 1983	First Half 1984	Second Half 1984	First Half 1985	Second Half 1985	Total
NWA									
Silver Bow	10,578.75	10,578.75	35,295.34	21,909.24	21,909.24	668.83	658.83		
Cascade	21,267.38	17,968.94	79,960.96	47,919.84	47,919.84	70,658.61	70,658.61		
Yellowstone	48,607.32	44,514.42	155,594.30	77,469.95	77,469.95	108,623.29	108,623.28		
Missoula	13,301.49	13,301.49	50,705.08	27,426.20	27,426.20	43,651.79	43,651.79		
L. & Clark	26,809.31	23,371.18	75,993.58	21,855.43	21,855.43	34,385.55	34,385.55		
Gallatin	18,424.20	18,170.21	55,262.31	18,071.66	17,892.67	26,965.53	26,632.98		
Total	138,988.45	127,904.99	452,811.57	214,652.32	214,473.31	286,953.60	286,631.04	1,718,415.28	

	First Half 1982	Second Half 1982	First Half 1983	Second Half 1983	First Half 1984	Second Half 1984	First Half 1985	Second Half 1985	Total
NAT									
Silver Bow	31,381.13	31,381.13	22,029.00	22,029.00	15,672.91	15,672.91	34,883.02	34,883.02	
Cascade	36,869.32	31,151.10	17,597.08	17,597.08	24,473.88	24,473.88	46,760.90	46,760.90	
Yellowstone	35,386.74	32,407.06	10,038.56	10,038.55	16,132.61	15,691.58	33,656.29	33,656.27	
Missoula			19,477.03	19,477.03	15,552.21	15,552.20	27,605.83	27,605.83	
L. & Clark			12,634.05	12,634.05	13,774.28	13,774.28	24,635.47	24,635.47	
Gallatin			13,606.36	13,505.87	21,270.26	21,075.37	32,112.17	31,715.38	
Flathead			2,896.58	2,636.34	6,784.46	6,373.78	13,969.35	13,076.10	
Total	103,637.19	94,939.29	98,278.66	97,917.92	113,660.61	112,614.00	213,623.03	212,332.97	1,047,003.67

	First Half 1982	Second Half 1982	First Half 1983	Second Half 1983	First Half 1984	Second Half 1984	First Half 1985	Second Half 1985	Total
ZAT									
Silver Bow	18,692.52	15,793.42	30,774.56	30,774.56	25,647.86	25,647.86	19,717.89	19,717.89	
Cascade	45,640.49	41,797.39	74,390.25	74,390.25	56,423.67	55,346.97	49,048.51	49,048.51	
Yellowstone	19,335.10	19,335.30	33,345.15	33,345.15	24,498.30	24,498.29	21,096.13	21,096.13	
Missoula	18,735.62	16,332.88	31,409.68	31,409.68	27,856.37	27,310.17	14,869.44	14,869.44	
L. & Clark	24,321.57	22,314.05	41,582.31	41,316.29	20,668.96	20,126.62	18,421.77	19,685.49	
Gallatin	9,096.38	7,577.87	15,918.01	14,487.95	13,044.30	12,254.71	11,905.37	11,144.09	
Total	135,821.88	123,150.91	227,419.96	225,723.88	168,139.46	165,184.62	135,059.11	135,561.55	1,216,061.37

* Reduced by 1,737.05 refund received in 1983 for taxes paid in 1982

	First Half 1982	Second Half 1982	First Half 1983	Second Half 1983	First Half 1984	Second Half 1984	First Half 1985	Second Half 1985	Total
UAL									
Silver Bow							275.54	275.54	
Cascade							22,233.19	22,233.19	
Yellowstone							15,523.84	15,523.82	
Flathead							64.67	64.67	
L. & Clark							130.17	130.17	
Total							38,227.41	38,227.39	76,454.80

S.B.8
Exhibit 2
March 26, 1986

NORTHWEST 1985

NEW WSATA

MOBILE FACTOR

total tons	1.803X
total equated hours	0.115X

average	0.959X

TERMINAL FACTOR

Montana term property	2,069,174	
-----	-----	0.238X
System term property	869,401,208	

PROPERTY PERCENTAGES

total flight property	2,130,020,139	71.01X
total terminal property	869,401,208	28.99X

	2,999,421,347	

FACTOR COMPUTATION

mobileX X mobile factor	0.681X
terminalX X terminal factor	0.069X

	0.750X

SYSTEM VALUE	1,104,723,400
MONTANA VALUE	8,285,575

WESTERN 1985

NEW WSATA

MOBILE FACTOR

total tons	2.176X
total equated hours	2.182X

average	2.179X

TERMINAL FACTOR

Montana term property	846,095	
-----	-----	0.357X
System term property	237,275,098	

PROPERTY PERCENTAGES

total flight property	923,114,591	79.55X
total terminal property	237,275,098	20.45X

	1,160,389,689	

FACTOR COMPUTATION

mobileX X mobile factor	1.733X
terminalX X terminal factor	0.073X

	1.806X

SYSTEM VALUE	424,507,268
MONTANA VALUE	7,668,110

FRONTIER 1983

HOURS AND ARRIVALS & DEPARTURES EQUATED

MOBILE FACTOR

total tons	2.855X
total equated hours	2.779X
revenue ton miles	1.530X
arrivals & departures (equated)	2.587X

average	2.438X

TERMINAL FACTOR

Montana term property	1,169,515	
-----	-----	0.914X
System term property	127,973,433	

PROPERTY PERCENTAGES

total flight property	497,228,144	79.53%
total terminal property	127,973,433	20.47%

	625,201,577	

FACTOR COMPUTATION

mobileX X mobile factor	1.94X
terminalX X terminal factor	0.19X

	2.13X

SYSTEM VALUE	254,241,350
MONTANA VALUE	5,415,341

UNITED 1985

HOURS AND ARRIVALS & DEPARTURES EQUATED

MOBILE FACTOR

total tons	0.0953%
total equated hours	0.0532%
revenue ton miles	0.0155%
arrivals & departures (equated)	0.0957%

average	0.0649%

TERMINAL FACTOR

Montana term property	455,679	
-----	-----	
System term property	1,204,115,000	0.037%

PROPERTY PERCENTAGES

total flight property	4,187,184,960	77.67%
total terminal property	1,204,115,801	22.33%

	5,391,300,761	

FACTOR COMPUTATION

mobilex X mobile factor	0.0504%
terminalx X terminal factor	0.0083%

	0.0587%

SYSTEM VALUE	2,428,005,750
MONTANA VALUE	1,424,951

EXHIBIT 3

DETERMINATION OF CAPITALIZATION RATE

Pages ii and iii of this exhibit illustrate how the capitalization rate was developed for tax year 1985 and how it is to be calculated for 1985 methodology.

The cap rate is developed by the Band of Investment method. Under that method the costs of capital, debt and equity are proportionately weighted and given respective rates as shown on pages ii and iii. The rates are developed for the industry as a whole.

- (1) The weights applied to debt and equity are determined by averaging book costs and market costs for the industry sample shown on page ii, item 1.
- (2) The rate for the debt component is determined by a twelve month weighted average of the market rate offered by the airline industry as shown on page iii.
- (3) The equity rate was determined by an average of earnings to book (E/B) and earning/price (E/P) ratios for the airline industry. The calculation is found on page ii, item 2.
- (4) The final cap rate is calculated on page ii, item 3. Here the rate for debt is multiplied by the proportionate weight for debt and the rate for equity multiplied by the proportionate weight for equity. The results of these products are added to arrive at the capitalization rate.

In no event, however, shall the capitalization rate either be lower than 12% or higher than 18%. If the capitalization rate as determined according to this exhibit is lower than 12%, then for that year it shall be 12%; similarly, if the capitalization rate as determined under this Exhibit 3 is greater than 18% then it shall be 18%.

The sources for the financial data herein compiled are "Standard and Poors Bond Guide", "Standard and Poors Stock Guide" and "Value Line".

1985 AIRLINE CAPITALIZATION SPREADSHEET
STANDARD & POOR'S - VALUE LINE

2

ALASKA AIRLINES
AMERICAN AIRLINES
DELTA AIRLINES
EASTERN AIRLINES
FRONTIER AIRLINES
NORTHWEST AIRLINES
PEOPLE EXPRESS
SOUTHWEST
TRANS-WORLD COMP
UNITED WA
US AIR
WESTERN AIRLINES

SHARES (000)	HIGH	LOW	AVG PRICE COMMON	BOOK VALUE PER SHARE	MKT VALUE COMMON	BOOK VALUE COMMON	BOOK VALUE PREFERRED	BOOK VALUE DEBT	EPS	E/P	E/B
10,798	17.500	9.500	13.500	9.70	143,613	104,741		86,200	1.90	14.29%	19.59
48,431	12.500	4.875	8.688	30.80	420,744	1,491,675		804,400	1.96	22.56%	6.56
39,761	45.875	27.000	36.438	26.58	1,448,791	1,048,895		2,450,200	4.42	12.15%	16.76
41,506	7.750	3.500	5.625	2.05	232,346	84,677	191,500		2.00	35.56%	97.56
11,598	14.625	8.250	11.438	14.65	132,652	169,911		200,600			
21,737	49.000	33.500	41.250	42.55	896,651	924,909	86,500	100,000	4.10	9.94%	9.64
21,138	22.600	7.600	15.100	7.00	319,184	147,966		318,600	0.55	2.52%	5.00
29,502	28.500	14.800	21.550	12.20	635,768	359,924		161,400	1.65	7.66%	13.52
32,578	14.000	7.875	10.938	17.00	356,322	553,826	193,200	1,226,700	1.00	9.14%	5.88
34,617	46.750	28.000	37.375	46.50	1,293,810	1,609,691	246,900	1,352,800	6.93	18.54%	14.90
22,998	35.000	22.000	28.500	31.55	655,443	725,587	2,500	43,600	5.00	17.54%	15.85
24,104	5.500	2.625	4.065	0.90	97,923	21,694	44,900	507,600			
28,214	24.933	14.110	19.522	20.11	6,633,248	7,243,495	765,100	7,252,100	2.93	14.97%	20.51

1

	MARKET	BOOK VALUE PREFERRED	BOOK VALUE DEBT
COMMON	6,633,248	7,243,495	7,252,100
DEBT	7,252,100	7,252,100	
COMMON	13,885,348	14,495,595	
DEBT			
COMMON	47.77%	49.97%	
DEBT	52.23%	50.03%	
	100.00%	100.00%	

3

WEIGHTED COST OF CAPITAL	COMMON STOCK	LONG-TERM DEBT
	48.87%	51.13%
	17.74%	12.15%
	8.67%	6.20%
	14.87%	

S.B.S
Exhibit 2
3-26-86

EXHIBIT

3

AIR_SPREAD

AIRLINE BONDS 1985 CAP STANDARD & POORS BOND GUIDE

	JAN	FEB	MARCH	APRIL	MAY	JUNE	JULY	AUG	SEPT	OCT	NOV	DEC	MTD AVG
AMERICAN AIRLINES	10.120	10.134	11.220	11.270	10.178	10.753	9.480	9.585	9.150	9.235	9.095	9.050	9.630
CONTINENTAL	12.040	12.070	12.170	12.340	13.030	12.970	12.930	12.010	12.140	12.170	12.010	11.820	12.263
DELTA	16.510	16.570	16.993	17.143	17.617	17.885	17.993	18.053	17.700	17.070	16.997	17.020	17.387
EASTERN	6.790	6.780	6.770	6.760	6.890	6.820	6.700	6.790	6.760	6.760	6.710		6.766
FRONTIER													
NORTHEAST													
NORTHWEST													
REPUBLIC													
TRANS WORLD	9.770	9.770	9.918	9.998	10.270	9.895	9.773	9.515	10.828	10.776	10.726	10.384	10.284
UNITED LAL													
WESTERN	12.340	12.595	14.850	16.010	16.600	16.320	17.730	17.990	16.230	15.810	16.410	16.960	16.452
AIR BONDS													12.130

S.B.8
 Exhibit 2
 3-26-86

BN Statement on Property Tax Settlement
March 25, 1986

The Burlington Northern Railroad signed an agreement with the State of Montana in an effort to solve a pending property tax dispute. Simply put, BNR is entitled to non-discriminatory treatment under the 4R Act in the State of Montana and believes that HB 240 violates provisions of that Act. In addition, BNR would like to move beyond this dispute to develop a more positive working relationship with the state and would like to provide the State's local governments and school districts with a stable and reliable source of revenue. BNR was faced with a difficult choice -- a negotiated settlement such as is before the Legislature now or the courtroom. BNR chose to pursue the option which can solve the dispute for the next six years and pursue the objectives mentioned above.

BACKGROUND ON 4R ACT

Section 306 of the 4R Act requires that railroads be subject to state property tax at the same rate as the average of all other commercial and industrial property taxpayers in the taxing jurisdiction. This means that, in the State of Montana, the statutory property tax classification rate imposed upon railroads must equal the average of the statutory property tax classification rates imposed upon all other commercial and industrial properties. It also means that if railroad property is appraised annually, while other commercial and industrial properties are appraised every five years, the disparity between the market value and the assessed value of those properties must be reflected in an equalization adjustment to the value of the railroad property. The discrimination which the 4R Act is designed to eliminate is demonstrated by the following hypothetical example:

Market Value	\$100	Railroad Property	Other Commercial and Industrial Property
Assessed Value	\$100		\$100
Tax Classification	15%		50% (equalization disparity)
Taxable Value	\$15		10% (classification disparity)
			\$5

The difference between the assessed and market value in the above hypothetical creates a wide disparity between assessed and market value of railroads compared to the assessed market value of other commercial and industrial property. In the example above, the disparity requires an equalization adjustment of 50% under the 4R Act. The difference in tax classification rates compounds the illegal disparity. The final result is a taxable value for railroads three times as great as that for other commercial and industrial property.

FEDERAL COURT FINDINGS

Prior to the enactment of HB 240 in April 1985, Montana's statutory property tax classification rate for railroads was 15%, and Montana's statutory scheme provided no equalization adjustment. In 1982, U.S. District Judge Batin found that Montana's property tax illegally discriminated against railroads in both respects. The Court made the following Findings of Fact:

" Subsequent to valuation, railroad property is then classified in order to arrive at a taxable value. There is a disparity between the taxable value of the railroad property and all other commercial and industrial property. In 1980, the tax assessed against railroad property was approximately 54% higher than other commercial and industrial property of equal value."

Railroad property is assessed annually, while most other commercial and industrial property is periodically assessed on a five-year cyclical basis. See MCA §15-7-111 (1979). It is apparent that this disparate treatment renders railroad valuations consistently unequal from other property and mandates equalization. However, defendant [Mt DOR] has failed to equalize railroad property in relation to assessment levels applicable to locally assessed commercial and industrial property among the counties. The assessment ratio applicable to locally assessed property exceeds the assessment ratio applicable to railroad property by more than 5%. Due to the differences in the frequency of cyclical reappraisal among property within the state, the railroads suffer de jure taxation discrimination.¹

With a backdrop of these Findings of Fact the State of Montana settled the litigation, since the only issue left for trial was a precise quantification of the discrimination involved in the property tax system. This settlement produced the following equalization rates and property tax payments by BNR in the State of Montana for the years indicated:

Year	Statutory Rate	Equalization Adjustment	Taxes Paid
1980	15%	50%	3,994,556
1981	15%	41.5%	4,627,094
1982	15%	32%	4,351,623
1983	15%	61%	5,265,589
1984	15%	55%	8,170,262
1985	15%	48.5%	8,787,780

PROPOSED LEGISLATION

Railroad property taxes under the proposed agreement are calculated with the following example. This example is provided only for illustration.

Total System Value	Montana's Allocation	Equalization Adjustment	Tax Mill Rate Levy	Tax
\$3.6 billion	.1413	70%	12% 248	10.62

Based on current Department of Revenue estimates, HB 240 will produce an estimated tax rate of 14% in 1986. HB 240 as enacted also applies a sales assessment ratio to railroad and airline property in recognition of the fact that other commercial and industrial property is reappraised every five years, while railroad and airline property is reappraised annually. Such a sales assessment ratio will cause the effective rate to decline. Since oil net proceeds comprise such a large part of the HB 240 formula, declining oil prices would cause the effective tax rate under the current law to go lower.

The proposed settlement also provides for the phasing in during the term of the settlement of a system of accounting known as depreciation accounting (DA). Contrary to certain assertions, DA accounting is not required by the ICC for all purposes. Rather, the ICC specifically uses an alternative method of accounting (known as RRB) for determining the rate of return of railroads. Moreover, state courts in both California and Idaho have recently rejected the principles of DA accounting in favor of the principles of RRB accounting for purposes of the valuation of railroad property.

¹ Burlington Northern, Inc., et al. v. Department of Revenue, CV-80-139-BLG, Findings of Fact and Conclusion of Law, ¶8 and 10 (July 26, 1982).

² Minimum guaranteed tax in 1986 is \$10.6 million

EXHIBIT 3 - S.B. 8
3-26-86

BURLINGTON NORTHERN RAILROAD

BURLINGTON NORTHERN RAILROAD

Ad Valorem Taxes - 1984

<u>State</u>	<u>Ad Valorem Tax</u>
Alabama	\$ 156,742
Arkansas	\$ 165,232
California	\$ 71,600
Colorado	\$ 1,127,955
Florida	\$ 53,000
Idaho	\$ 305,348
Illinois	\$ 1,620,000
Iowa	\$ 1,820,000
Kansas	\$ 832,209
Kentucky	\$ 2,000
Minnesota	\$ 4,892,000
Mississippi	\$ 112,596
Missouri	\$ 1,394,457
Montana	\$ 8,170,262
Nebraska	\$ 5,950,132
New Mexico	\$ 78,960
North Dakota	\$ 1,486,078
Oklahoma	\$ 893,707
Oregon	\$ 1,701,867
South Dakota	\$ 205,000
Tennessee	\$ 240,000
Texas	\$ 661,489
Washington	\$ 4,445,000
Wisconsin	\$ 1,480,429
Wyoming	\$ 1,375,304
Total	\$39,240,480

Ad Valorem Taxes-paid in
the State Of Montana

1979 -	\$ 4,369,844
1980 -	3,994,556
1981 -	4,627,094
1982	4,351,623
1983	5,265,589
1984	8,170,262
1985	8,787,780
1986	10,600,000

STATEMENT BY FORWARD BILLINGS ECONOMIC DEVELOPMENT COUNCIL
BEFORE THE LEGISLATIVE COMMITTEE(S) OF THE SPECIAL SESSION
OF THE MONTANA LEGISLATURE
MARCH 1986

Forward Billings is an economic development program sponsored by the Billings Area Chamber of Commerce. In 1983, a determination was made that an aggressive program needed to be mounted to encourage expansion by existing businesses and to attract to our area expanding businesses from other area. A professional study was contracted for to determine the structure of such an effort, the time required to anticipate success, the funding necessary to do the job and an assessment as to whether such funds could be raised. The result was that \$1,000,000 was raised from the business community of the Billings area for a four year program administered by the Forward Billings Council and executed by a full-time executive director and staff.

In order to raise the \$1,000,000, Forward Billings made four commitments to its supporters:

1) We would develop programs and pursue activities that would encourage and ensure incentives for existing businesses to grow and expand.

2) We would develop programs and opportunities that would attract new business and industry to our area.

3) We would document our successes and our failures and the reasons why we succeeded or failed.

4) By using this documentation and certain proposed studies, we would attempt to influence at both the local (cities/county) and state levels (legislative/executive) enactment of new legislation and changes in existing legislation and administrative attitudes which foster an economic environment that best aides the objectives, not of just the Billings area, but for the entire state.

As a result of attempting to carry out our mission and charge, Forward Billings became involved in "shuttle diplomacy" between the Burlington Northern and the Governor's Office as early as the first part of July 1985 relative to the anticipated effects of HB240.

On July 19 we suggested to the Governor that the only solution appeared to be a special session of the legislature to modify the effects of HB240 so that it unquestionably came into compliance with the 4R's Act. Any other course appeared to us would cause the following to occur:

1) BN would pay its taxes and immediately would sue for a refund.

2) The taxes paid by BN would be impounded and the schools and counties of the state would be denied the use of these funds for several years.

3) As the process continued, this state would send more and stronger anti-business messages to the outside world.

4) All of this would mean that the task before Forward Billings and Build Montana (when we are in probably the worst economic crisis since the 1930's) becomes almost insurmountable.

In the intervening months, nothing has occurred to change this original assessment. If anything, the adverse publicity, which had identified Montana as a anti-business state, demands even more that we resolve the anti-business implications of HB240 quickly.

Now, why should this legislation be passed:

1) This legislation settles this issue for a least five years for the airlines and six years for the railroad. It is time we got this issue put to sleep, it belongs behind us.

2) Current impounded funds would be released to the schools and counties. Future funds will not be impounded. Future lawsuits will not be the headlines of our papers and the Wall Street Journal.

3) We can, if you pass the legislation by a large enough majority, turn the adverse effects of HB 240 into the first of a series of positives Montana can send to the business investment community. We can begin to tell them "we are getting our act together."

4) We recognize that the proposed solution doesn't solve all problems, make all parties happy, contain total equity for all of us who pay taxes, but given the protection afforded railroads and airlines by the 4R's Act we can see release of all impounded funds, resolution of all losses present and future, at least 5-6 years of secure, planned for and usable tax dollars by our schools and counties, and lastly, a calming of voices, a working together of government and industry, an atmosphere of building (when we really need it) in a trusting relationship.

We plead with you not to hack this legislation to death over your differences. Lets get this issues behind us--PASS IT.

Forward Billings Economic
Development Council

Jase O. Norsworthy
Chairman

*Exhibit 5-S.B. 8
3-26-86*



REVENUE OVERSIGHT COMMITTEE

MONTANA STATE LEGISLATURE

SENATE MEMBERS

Robert J. (Bob) Brown
Vice Chairman
Bruce D. Crippen
Thomas O. Hager
Joseph P. Mazurek
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HOUSE MEMBERS

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John G. Harp
Dan W. Harrington
Nancy A. Keenan
Jack Ramirez

Dave Bohyer
Staff Researcher
(406) 444-3064

February 21, 1986

TO: Members, Revenue Oversight Committee
Interested Persons

FROM: Dave Bohyer, Staff Researcher *Dave*

RE: Taxation of Burlington Northern Railroad property

The attached tables and graphs are addenda to the report presented to the Committee at the January 10, 1986 Revenue Oversight Committee meeting titled, "Railroad Taxation Issues: A Discussion of Railroad Valuation, Options for Complying with the Federal 4-R Act, and A Comparison of Burlington Northern Railroad Property Taxation in Eighteen States".

The information is the result of the Committee's January 10 request for further state-by-state data on valuation and taxes paid on a per mile basis.

The information contained in the tables was collected from the responses to a survey questionnaire distributed in November 1985 to 24 states containing BN operating properties, and from telephone interviews conducted February 18 and 19.

All footnotes contained in the attached information are described in Appendix C, (pp. 63-68), of the previously mentioned "Railroad Taxation Issues" report.

db/BNADD/dw3

TABLE 4

Burlington Northern Railroad
Taxable Value Per Track Mile

State	BN Taxable in State (Millions)	Total Track Miles	Taxable Value Per Mile	Rank
Arkansas *	NA a	534.56	NA	NA
Colorado	92.857 b	1119.45	82,948.77	7
Florida	2.346	73.32	31,996.73	9
Idaho	61.119	464	131,721.98	3
Illinois	31.900	2302.96	13,851.74	13
Kansas	9.655	642	15,038.94	12
Kentucky	0.125	NA	NA	NA
Minnesota	122.300 l	4059	30,130.57	10
MONTANA	35.368 s	4370.91	8,091.68	14
Nebraska	362.200 v	2355	153,800.42	2
New Mexico	4.086	82.21	49,701.98	8
North Dakota	8.500 cc	4182.86	2,032.10	15
Oregon *	97.108	927	104,755.12	5
South Dakota	NA	NA	NA	NA
Texas *	156.000 nn	1514.13	103,029.46	6
Washington	371.899	2860	130,034.62	4
Wisconsin	81.951	335	244,629.85	1
Wyoming	26.975	958.79	28,134.42	11
TOTAL	1464.389	NA	NA	
AVERAGE	91.524312	NA	\$75,326.56	

TABLE 7

Burlington Northern Railroad 1985 Property Taxes
Paid Per Track Mile Ranking By State

Rank State	Property Tax Paid (Millions)	Total Track Miles	Property Tax Per Mile
1 Wisconsin	1.846	335	\$5,510.45
2 Nebraska	10.300	2355	4,373.67
3 Kansas	1.254 i	642	1,953.27
4 MONTANA	8.535	4370.91	1,952.68
5 Wyoming	1.819	958.79	1,897.18
6 Minnesota	5.300 n	4059	1,305.74
7 Washington	3.583 rr	2860	1,252.80
8 Oregon *	1.118	927	1,206.04
9 New Mexico	0.080	82.21	973.12
10 Florida	0.037	73.32	504.64
11 North Dakota	1.486	4182.86	355.26
NA Arkansas *	NA	534.56	NA
NA Colorado	NA	1119.45	NA
NA Idaho	NA	464	NA
NA Illinois	NA	2302.96	NA
NA Kentucky	0.001	NA	NA
NA South Dakota	NA	NA	NA
NA Texas *	NA	1514.13	NA

S.B.8
Exhibit 6-
3-26-86

BURLINGTON NORTHERN

Fact Sheet No. 3

Original Settlement Terms (Terry Cohea - 5 March 1986)

- 1) BN would not contest use of net and gross proceeds in the formula.
- 2) BN would not contest the formula used in HB 240.
- 3) BN would not protest the first \$10.6 million (gradually increasing to 12.1% by 1991 to reflect a 5-year phase out of old betterment depreciation method).
- 4) State would put a cap on the tax rate at 12% - the rate could not go higher.

Since huge reductions in net proceeds recently caused by the drop in oil prices would bring the rate down to 12.05% by 1987 -- the only loss to the State was approximately \$2.9 million (\$17.5 million - \$14.6 million) in 1986. (Admittedly, not all details had been worked out at this time.)

\$4 million error discovered (10 March 1986). (I asked why \$10.6 million instead of \$14.6 million - 12% under the formula of HB 240. It appears they were using figures from the fiscal note for SB 48 which was based on 1984 figures (\$2 million off) and before reductions in the formula caused by HB 410, SB 431, SB 234, and HB 240 (another \$2 million not counting the effect of net and gross proceeds.))

-- BN withdrew support for the formula at a 12% cap.

-- Governor's office agreed to a 70% (75% after 1986) adjustment factor which places the rate at 8.4% (9% after 1986) instead of 12%.

Financial Impact of current (signed) settlement agreement (assuming Montana would continue to recognize that "betterment depreciation" could be used by the railroad).

	Current Law (HB 240)	Final Settlement Agreement	Difference (Loss to Montana)
1986	\$ 17.5 million	\$ 10.6 million	\$ 6.9 million
1987	\$ 14.6 million	\$ 19.9 million	\$ 3.7 million
1988	\$ 14.5 million	\$ 11.2 million	\$ 3.3 million
1989	\$ 14.2 million	\$ 11.5 million	\$ 2.7 million
1990	\$ 13.9 million	\$ 11.8 million	\$ 2.1 million
1991	\$ 13.6 million	\$ 12.1 million	\$ 1.5 million
TOTAL DIFFERENCE (loss to Montana)			\$20.2 million

- Assumptions
- 1) Mill levy remains constant at 248.417 mills.
 - 2) Oil prices remain at \$15 per barrel.
 - 3) No increase in BN value (by acquisition of new equipment -- Average annual increase between 1976-1985 is 15.5%).

But BN is currently using a "cement Depreciation" system - e.g. \$100,000 investment in new track makes the track \$50,000 better, so \$50,000 is expensed and \$50,000 is added to capital to depreciate.

- System is not generally recognized by accountants.
- ICC recently ordered railroads to change to normal depreciation methods.
- California Court has recently ruled it can't be used in California for tax purposes.
- DOR officials were preparing 1986 valuations for BN (based on ICC ruling) without it.

-- The final settlement agreement allows BN to gradually phase out the system over 5 years.

-- If this "5-year phase out" benefit is considered, the Fiscal Impact of the Final Settlement is as follows:

	Current Law (HB 240)	Final Settlement Agreement	Difference (Loss to Montana)
1986	\$ 21.2 million	\$ 10.6 million	\$10.6 million
1987	\$ 17.8 million	\$ 10.9 million	\$ 6.9 million
1988	\$ 17.5 million	\$ 11.2 million	\$ 6.3 million
1989	\$ 17.2 million	\$ 11.5 million	\$ 5.7 million
1990	\$ 16.8 million	\$ 11.8 million	\$ 5.0 million
1991	\$ 16.5 million	\$ 12.1 million	\$ 4.4 million
TOTAL DIFFERENCE (loss to Montana)			\$38.9 million

- Assumptions
- 1) Mill levy remains constant at 248.417 mills.
 - 2) Oil prices remain at \$15 per barrel.
 - 3) No increase in BN value (by acquisition of new equipment -- Average annual increase between 1976-1985 is 15.5%).

Effective rate under the final settlement agreement.

- 8.4% (9% for 1997 and thereafter) - railroads

Other Montana Companies pay at higher rates:

- 16% - Trucks
- 16% - Ore Haulers
- 16% - Radio & TV Equipment
- 13% - Furniture and Fixtures
- 12% - Utilities (MPC, Mtn. States Telephone, MDU)
- 12% - Airlines*

*By signed agreement, the Airlines have agreed to pay at 12%. But after announcing a 30% reduction below 12% for railroads, Terry Cohea stated at the Revenue Oversight Committee meeting that the administration would now approach the airlines to see if they would amend their agreement to reduce their tax by 30% (25% in 1987 and after) to match the railroads.

The present tax is unfair to other taxpayers.

- Other companies own railroad track in Montana.

U-26-86
F.I.L.I. 7-5-88

Company	Sound Value	Length (Miles)	Per Mile Value
East Decker Coal*	\$3,526,000	4.706439	\$749,757.45
West Decker Coal	1,428,005	3.823864	373,670.49
Spring Creek Coal	6,868,800	10.100000	680,079.21
Westmoreland Coal	482,334	1.534091	314,410.31
Western Energy	1,105,200	4.200000	263,142.86
FLM Railcar Maintenance	1,261,200	15.643939	80,619.08
Farmers Union Grain	233,200	1.181818	197,323.08
AVERAGE	NA	NA	\$379,857.50

* Includes trestle

Value of BN track per mile - allocated and including all rolling stock (cars & engines) and other operating property (1985) - \$111,919.71 = 29.5% of other taxpayers

Tax paid by Farmers Union Grain on one mile of track - \$6,719
Tax paid by BN on spur line in the same county - \$ 246

Net and Gross proceeds are properly included in the formula - the 4R's Act says "Other commercial and industrial" property subject to the same tax in the state.

-- Net and gross proceeds are subject to the same tax in Montana.

- oil and coal held for resale is commercial property.

- they certainly are not "residential property" or "farm property" which are excluded from the formula.

-- 4 other Western states include mineral property in their railroad tax formula -

- Arizona
- Arkansas
- Kansas
- Utah

-- Arkansas & Utah have net and gross proceeds as does Montana.

The solution is to amend the Protest law that allows big taxpayers to pay protested taxes into escrow and hold local governments hostage until the litigation is settled.

-- Most states don't allow protested taxes to be paid into an escrow fund.

-- Others allow only 1/2 or some other fraction.

-- We should amend the law to allow only that portion of taxes that are genuinely at issue not to exceed 50% of the total tax bill to be placed in escrow. Then, BN would have to pay \$10.6 million to local governments to use and \$10.6 million in escrow

Exhibit 7-5-B.8
3-26-86

pending a final decision of the courts.

her srs:

- 1) BN earned \$619.8 million in gross receipts on its Montana properties last year.
 - They can well afford to pay 3.42% of that in tax.
 - Montana Power Company pays 7.19% of total revenues.
 - Mountain States Telephone pays 6.99% of total revenues.
 - Under the settlement - BN would pay 1.71% of total revenues.
- 2) According to Forbes Magazine, BN was 41st most profitable company in the nation in 1984 with \$608 million in net profits - up 47.2% from the year before.
 - Sales were up 103.1% making it the leader in the nation in sales growth.
 - Reports from the last quarter indicate 1985 is still higher.
- 3) 85% of Montana grain is hauled by the BN.
100% of Montana coal is hauled by the BN.
 - There is no competition.
 - Montana farmers pay 87% more in freight rates per car mile than do Nebraska farmers - to the same railroad for some of the same cars and track because BN has competition in Nebraska.
 - One of the supplemental appropriations will allow the state to continue its lawsuit against the BN for unreasonable freight rates.
- 4) We don't have access to state income tax records for BN, so we can't determine whether they are paying their fair share of state income taxes. We do know BN paid no (net) federal income taxes for the last 4 years (1981 - 1984). In fact, it received a \$1.1 million refund on \$2.8 billion of income. Our corporate license tax laws are very similar to the federal income tax laws.

Thomas E. Towe
March 25, 1986

Governor's
Settlement

12%

Current Law
HB 24

\$21.1 million \$14.6 million \$10.6 million

1. Summary -- Current Law
2. Loss over next six years -- \$38.9 million
3. Effective tax relief for BN (1986) -- 50% (\$21.1-10.6 million)
4. Effective tax rate (after eliminating betterment depreciation) equals 7.2% (7.4% after 1986)
 - Airlines agreed to 12%
 - Utilities pay at 12%
 - Trucks, ore haulers 16%
 - Radio & TV equipment 16%
 - Furniture & fixtures 13%
5. Settlement is lower than Jack Ramirez's original formula in HB 240.
6. We spent 2 years working out a formula that would comply with federal law. The only issue is inclusion of net and gross proceeds in the formula. Taxes on minerals are included in railroad formulas of four other states:

- Arizona
- Arkansas
- Kansas
- Utah

It defies logic to exclude minerals. It is a property tax on property held for resale--commercial property.

7. But even if we lose this issue in court:

BN will pay	11.8
Governor's settlement	10.6
	<u>1.2 million</u>

The Governor's settlement is \$ 1.2 less than if BN won in court.

8. Agreement provides that if the Legislature rejects agreement, both parties will continue to negotiate.
9. Seven other non-railroad companies own railroad tracks in Montana. They pay over 3 times the tax per mile of rail (assuming a main line comparison).
 - Farmer's Union Elevator, Glasgow, pays \$6719 tax
 - BN pays, on its spur line in Glasgow 246 tax
10. Forbes Magazine says BN was the 41st most profitable company in the nation in 1984.
11. At \$21.1 million, the BN will still pay less than the Montana Power Company -- \$24 million and MPC makes only one-half the gross income on its Montana properties.