

MINUTES OF THE MEETING
TAXATION COMMITTEE
SECOND SPECIAL 49TH LEGISLATIVE SESSION
HOUSE OF REPRESENTATIVES

March 26, 1986

The first meeting of the Taxation Committee was called to order in room 312-1 at 7:10 p.m. by chairman Devlin.

ROLL CALL: All members were present as were Dave Bohyer, legislative researcher for the Legislative Council, and Alice Omang, secretary.

CONSIDERATION OF HOUSE BILL 15: Representative Williams, house district #85, said that this bill would limit the tax rate applicable to class fifteen property and this would return the tax rate on Burlington Northern from the 14% in HB 240 to the 12% that was in SB 48, which did not pass the last session. He advised that on February 21, the governor's office presented a report to the revenue oversight committee and there were a lot of unanswered questions on the negotiations with the Burlington Northern railroad, but the objectives were to return to the tax level proposed by this committee in SB 48 for the railroads and airlines, to avoid potential litigation and insure that the local governments and school districts receive their tax revenue, to establish a rate that is fair to other Montana taxpayers, fair to the railroads and airlines and a rate in compliance with the 4R act. He feels that this bill will do everything that the governor requested. He informed the committee that this puts a cap on HB 240 at 12% and leaves everything else there as it was passed in 1985. He feels that this bill is fair and defensible.

PROPOSERS: There were none.

OPPOSERS: Stanley Kaleczyc, representing the Burlington Northern, offered a handout for the committee's consideration. See Exhibit 1. He stated that SB 48 was silent on the question of equalization, which says that railroad property is appraised annually and other commercial and industrial property is assessed every five years in Montana; and this results in a disparity between the market value of other commercial and industrial property and the

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assessed value, which is frozen at the time of the initial assessment for a five-year period. He indicated that in the HB 240 formula and HB 15 formula, equalization is applied only to class 4 property and they believe that that is an inherent deficiency. He said that this is a movement in the right direction, but it does not comply with the 4R act requirement.

He informed the committee that this bill is an alternative to SB 8, Senator VanValkenburg's bill, which is based upon a settlement that was reached with a written agreement between the Burlington Northern railroads and the department of revenue. At this point, he explained the information contained in exhibit 1. He indicated that he hoped the committee would have the opportunity to hear SB 8 and give it more favorable consideration than HB 15.

Representative Cohen, house district 3, rose as an opponent to this legislation saying at one time there were some negotiations - not involving just the railroad and one individual from the governor's office - but all the committees of the legislature; and, as a result of this negotiation, SB 48 came before us at this table and the railroad did not get up and support that bill.

There were no further opponents.

QUESTIONS ON HOUSE BILL 15: Representative Keenan asked about the status of the good-faith negotiations if the agreement was not ratified by the legislature - would they sit down with them again and at least talk.

Mr. Kaleczyc advised that the agreement said that there would be an attempt made to continue with negotiations and if HB 15 becomes the law in Montana rather than SB 8, he would assume that the parties would come together and negotiate in good faith; but they cannot assume that that will result in a new settlement - there will be a roll of the dice.

Representative Keenan asked why he did not think it was proper on the issue of net and gross proceeds, or minerals as she called it.

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Mr. Kaleczyc responded that the basic problem when you are taxing net and gross proceeds, you are taxing the value of the extracted mineral, oil or gas. He felt that was something more like an income tax or a sales tax and not a property tax. He noted that there are also gas, oil or mineral reserves under the ground that are part of that individual's property; so merely to tax net and gross proceeds with no consideration of the reserves is not, in his view, a property tax. He contended that there were two states that have been identified as having net and gross proceeds taxes, other than Montana, and neither of those states uses net and gross proceeds in its determination of the rate applicable to all other commercial and industrial taxpayers. He said there are a few states that tax the value of mines and related mining equipment, but they do not do it on a net and gross proceeds basis. He concluded that there is no other state in the union that has a net and gross proceeds tax that is made part of the calculation for the classification pursuant to the 4Rs act.

Representative Keenan asked why this was not in the agreement.

Mr. Kaleczyc answered, "Because it is a settlement." He explained that under the terms of the settlement, there is a 12% rate, there is an equalization factor and the agreement specifically says that the Burlington Northern railroad does not conceive that this is a proper method of taxation and that issue is left open for litigation down the road.

Representative Harp said that there was a question about equalization and not following the 4Rs act. He contended that, other than class 4, all other classes in the R factor are annually assessed and have current values and the only place of disparity of equalization is under class 4. He said that they recognize the disparity between your 1986 values and our 1982 values and the assumption is that maybe that figure of 80% should be used there. He continued that under the formula in this bill, that rate would now be 3.09 - in other words, readjusting that rate and following the equalization, so he felt the question of equalization is addressed. He stated that never did the 4Rs act say that we could not include minerals.

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Mr. Kaleczyc replied that the assumption is made that all the other property in the various classes is personal property and he feels that is an assumption that the railroad would not agree with. He noted that there is undoubtedly personal property in the state that is not reported or under reported and that creates a disparity; and it is difficult to measure what that disparity is.

Representative Harp asked what is the unit value of Burlington Northern.

Mr. Kaleczyc responded that in 1985, using the methodology in the last year of the settlement agreement entered into in 1982-1983, it was calculated at \$3.5 billion. The railroad would probably disagree with their methodology and would say that the correct number should be \$2.5 billion; however, a settlement was entered into, he advised.

Representative Harp noted that if they go with the senate bill, Burlington Northern will agree to \$3.5, but if they don't go with the senate bill, they would go back to \$2.5; and in talking with the department of revenue, their values for 1986 is an increase of \$4.2 billion; and if you look from 1976 to 1985, their values have annually increased by 15%, so they have a disparity possibly of more than \$1 billion - it would seem to him it was closer to \$2 billion, if they go on 1986 values.

Mr. Kaleczyc said that he would assume that that \$2.5 represents either a 1984 or a 1985 computation, and if the interest rate and everything else has gone up, the railroad's expert would probably bump up that \$2.5 to some other number. He handed to the committee exhibit 2.

Representative Harp noted that while the governor was working on the railroads, there were also some concern involving the airlines and the airlines agreed to pay at a full 12% and also agreed that net proceeds will be the costs of commercial and industrial property involved in the means of assessing the R factor into the airlines. He contended that there seems to be some contradiction

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there as to if this is a property tax and he felt that this committee needs to get away from looking at that as an income off a piece of property and needs to look at it as a commercial piece of property that has either mining or oil production on it. He said that if they take class 1 and class 2 out, they change the R values by more than 25% statewide and by eliminating net proceeds, they drop the rate to almost an 8% R factor immediately.

Mr. Kaleczyc replied that he has not run a computation recently and he does not know if it goes down to 8%, but he thinks the number is going to be higher. As far as the airlines settlement, he indicated, that there is some reference that those concessions are only for purposes of the term of that particular agreement.

Representative Sands asked what might happen for a settlement in the future.

Mr. Kaleczyc responded that the same methodology will be in place that is in the settlement that is now pending and he does not know what the numbers will be for 1986, but in future years those numbers will change. He explained that as the railroad becomes a more profitable system, the system's value goes up and the taxes go up. He informed the committee that there is a figure of \$10.6 million in taxes that the railroad absolutely guarantees to pay in 1986, even if the system value drops and they come up with a tax bill of less than this. He advised that this is a 20% increase over 1985.

Representative Sands asked if he would explain what is defective about the equalization scheme contained in this bill.

Mr. Kaleczyc stated that the equalization adjustment should be made to system value or to the taxable value, but it should be an adjustment made to the railroad's value; this bill and HB 240 makes that equalization adjustment to class 4 property only and they feel that that is not a proper way to equalize the value.

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Representative Sands asked where in this bill does this say that it applies to class 4 property only.

Mr. Kaleczyc replied that he didn't know if it says that in black and white, but part of the problem of all of this is that there are a lot of court cases and there are a lot of things that are not stated in a clarity that is preferred, but he can say that that is the way it works.

Representative Asay asked if the appraisal of property for five years does not change by inflation.

Mr. Kaleczyc responded that one of the changes is obviously inflation, but market value, supply and demand and all these things are another factor, and they all affect disparity.

Representative Asay asked if, in a time of no inflation, would there be any great discrepancy between the railroad property and those appraised every five years.

Mr. Kaleczyc answered that he felt there would be a discrepancy, but it may not widen as fast as it would during a period of inflation.

Representative Keenan noted that the unit value in California is \$6.5 billion and in Wyoming, it is as low as \$2.5 billion and she asked why there is that difference across the nation.

Mr. Kaleczyc replied that the railroad expert in a settlement agreement said that this was the value in Wyoming and, in California, there is a proposed final decision pending that has stricken some portions of the method by which California calculates the value of railroad property - they annually have litigation involving value in California and a December, 1985 decision came in very favorable to the railroads and against the California board of equalization.

Representative Keenan asked how many agreements and settlements there were in other states.

Mr. Kaleczyc responded that he did not know if there had been a settlement in every state, but in some of the states, litigation is proceeding over the question of value.

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Representative Harp noted there was a phasing-in act of the governor's five-year agreement - basically the difference between betterment and depreciation - and asked what would be the effect on the state by going to that difference in accounting by Burlington Northern.

Mr. LaFaver responded that the impact would be about as Mr. Kalkeczyc outlined and if they make the comparison about where they would be in value, simply staying with the present method of betterment accounting, they have a system value of about \$3.5 billion. He continued that they phase into a 4.1 or so system value and with the signed agreement, that results in \$300,000.00 additional tax paid every year. He said that it is certainly to the state's advantage to move to that rather than to stay with the existing valuation.

In response to the question by Representative Harp, Mr. LaFaver indicated that this was assured; this is what the Burlington Northern said there is no legal issue, if the legislature ratifies it, that is money in the bank. He commented that he could not say if the state would move in 1986 to a full agreement as there is a process by which Burlington Northern submits what they think their value is, there is a discussion with the staff of the department and later in the spring, the department sets the assessed value. He stated that if they could go immediately and defend that successfully, that would be more money than is contained in the agreement, but there is no assurance that a court would agree with whatever value they came up with.

Representative Harp asked a question concerning the I.C.C.

Mr. LaFaver replied that he read the I.C.C. order and there was language that alluded to the concern that the railroad had expressed -that tax agencies were going to see what they are doing and, all of a sudden, the values are going to go way up simply because they changed the accounting method. He explained that there was language in the order advising the states to be mindful of this and to encourage a phase-in.

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Representative Williams asked how they arrived at the 70% and 75% factor used in the agreement.

Mr. Kaleczyc replied that they were negotiated numbers and that is part of the settlement. He clarified that the 1986 number is 70% and the 1987 through 1991 is a constant 75%. He thought that if you were to use the ratio studies over the years, somewhere along the line that equalization rate is going to fall below 75%.

Representative Sands asked if SB 8 is really the appropriate way to establish tax rates in this state, because in dealing with the big companies that have access to the 4 Rs act, should they negotiate with them through the governor's office and then come back and ask the legislature to approve their settlement or should they try to figure out what is the best tax rate possible, set that and make that the rate.

Mr. LaFaver answered that it is a tough issue, but the commitment they had was to bring the best agreement to them that they could and he does not know anyone that was part of it that is completely comfortable with it. He stressed that whatever its flaws, they hope they can resolve this issue and this is the best that can be done.

Representative Keenan indicated that there is in congress now legislation much as the 4Rs act on pipe lines. She asked if it was the governor's position that they should also negotiate on pipe lines.

Teresa Cohea, Executive Assistant to the Governor's Office, responded that she could not comment on a hypothetical question that congress has not acted upon, but she is sorry that they are considering adding one more limitation to the state legislatures' abilities to set their own tax policies. She advised that they litigated all the way to the supreme court to reserve their right to set the coal tax policy and the reason they are all having these discussions today is because congress limited their (the legislature's) ability to decide for the people of Montana what the right rate of tax the airlines and railroads is. She said that this has been under discussion for nearly 10 years in the Montana legislature and asked how you comply with the 4R act and come up with what the legislature perceives is a fair rate.

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Representative Ream noted on the handout (exhibit 1) that it showed the ad valorem tax for the various states, but it did not show the valuation and he requested that Mr. Kaleczyc furnish the committee with this information.

Mr. Kaleczyc replied that he would try and get that information for them.

Representative Williams noted that they agreed to pay so much in taxes from 1986 to 1991 and in that agreement, they apparently agreed that they owed that much taxes.

Mr. Kaleczyc replied, "No, they agreed that if the settlement were put in place with equalization and all the other features of that agreement, that the tax for 1986 would be \$10.6 million and in future years would be determined consistent with that negotiated agreement. That agreement also says that if the legislature does something different or does nothing and can't resolve the differences, all bets are off. If you are asking, will they take \$10.6 million without the agreement, Representative Williams, I kind of doubt it." He continued that the railroad feels that they are paying more than they ought to.

Representative Williams questioned if he believes that, if they went to court and put the total tax in escrow, would the court not take a dim view of the fact that they had already pledged an agreement.

Mr. Kaleczyc answered that when you go into federal court and say that a particular state is discriminating against them in violation of the 4Rs act and they want an injunction against the state, you have to indicate to the court what you feel is the legal amount of the taxes and you pay that to the state and to the counties. He continued that the portion that you contest then goes into the escrow account and this is a negotiated settlement and he thinks there is not a single federal judge that does not appreciate that it is an attempted settlement. He contended that settlement negotiations are not admissable in federal court

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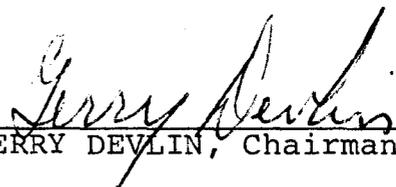
proceedings and he does not think either the state or the railroad is prejudiced by the agreement.

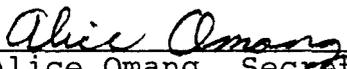
There were no further questions.

Representative Williams stated that he felt secure in SB 48 in the 1985 session with the formula they built in and the way they segregated the properties that they had built in the equalization factor in the formula. He said he still believes that HB 240, as it passed, has the equalization built into it, and he does not believe that they need that 70 and 75% reduction.

The hearing on this bill was closed.

There being no further business, the meeting adjourned at 8:30 p.m.


GERRY DEVLIN, Chairman


Alice Omang, Secretary

DAILY ROLL CALL

TAXATION

COMMITTEE

49th LEGISLATIVE SESSION -- 1986
 Second Special

Date 3/26/86

NAME	PRESENT	ABSENT	EXCUSED
DEVLIN, Gerry, Chairman	✓		
WILLIAMS, Mel, Vice-Chairman	✓		
ABRAMS, Hugh	✓		
ASAY, Tom	✓		
COHEN, Ben	✓		
ELLISON, Orval	✓		
GILBERT, Bob	✓		
HANSON, Marian	✓		
HARRINGTON, Dan	✓		
HARP, John	✓		
IVERSON, Dennis	✓		
KEENAN, Nancy	✓		
KOEHNKE, Francis	✓		
PATTERSON, John	✓		
RANEY, Bob	✓		
REAM, Bob	✓		
SANDS, Jack	✓		
SCHYE, Ted	✓		
SWITZER, Dean	✓		
ZABROCKI, Carl	✓		

Exhibit 1
HB 15
Stan Koleczye
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, BNRR 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, BNRR 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. BNRR was faced with a difficult choice -- a negotiated settlement such as is before the Legislature now or the Courtroom. BNRR 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:

	Railroad Property	Other Commercial and Industrial
Market Value	\$100	\$100
Assessed Value	\$100	\$50 (equalization disparity)
Tax Classification	15%	10% (classification disparity)
Taxable Value	\$15	\$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 Battin 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 BNRR in the State of Montana for the years indicated:

<u>Year</u>	<u>Statutory Rate</u>	<u>Equalization Adjustment</u>	<u>Taxes Paid</u>
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.

<u>Total System Value</u>	<u>Montana's Allocation</u>	<u>Equalization Adjustment</u>	<u>Tax Mill Rate</u>	<u>Levy</u>	<u>Tax</u>
\$3.6 billion	.1413	70%	12%	248	10.6 ²

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

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

BURLINGTON NORTHERN RAILROAD

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

TABLE 8

THE REVENUE IMPLICATIONS OF
A 12 PERCENT TAX RATE, THE GOVERNOR'S PROPOSAL
AND DOR'S 1985 UNIT VALUE

10151

YEAR	UNIT VALUE	ALLOCATED VALUE	TAX RATE	TAXABLE VALUE	MILL LEVY	TAX PAYABLE	GOVERNORS		ESTIMATED LOSS
							TAX PAYABLE	TAX PAYABLE	
1985	\$3,462,077,000	\$489,191,000	15.00%	\$35,368,509	248.417	\$8,787,780	NA	NA	NA
1986	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$10,600,000	\$3,982,803	\$3,982,803
1987	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$10,900,000	\$3,682,803	\$3,682,803
1988	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$11,200,000	\$3,382,803	\$3,382,803
1989	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$11,500,000	\$3,082,803	\$3,082,803
1990	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$11,800,000	\$2,782,803	\$2,782,803
1991	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$14,582,803	\$12,100,000	\$2,482,803	\$2,482,803
AVG ESTIMATED TOTAL	\$3,462,077,000	\$489,191,000	12.00%	\$58,702,920	248.417	\$87,496,820	NA	\$68,100,000	\$19,396,820

SOURCES: "Property tax paid" from Great Falls Tribune, 3/14/86. \$4.2 billion unit value is DOR estimate for 1986. Legislative

Council estimates.

- Assumptions:
- Allocation Factor of 14.13%
 - 1985 Average Mill Levy of 248.417 mills
 - Amount of tax from 3/14/86 Tribune article
 - The tax rate remains constant at 12%
 - The unit value is constant at 1985 level
 - * The amount of tax loss is variable and dependent

Exhibit 2
HB 15
3/26/86
Stan Kaleozyc

WITNESS STATEMENT

NAME STAN KALECZYC BILL NO. HB 15
ADDRESS 28 N LAST CHANCE HELENA DATE 3-26
WHOM DO YOU REPRESENT? BURLINGTON NORTHERN INC
SUPPORT _____ OPPOSE 2 AMEND _____

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

Comments:

EQUALIZATION IS AN ISSUE
COMPARISON TO SBF