HOUSE TAXATION COMMITTEE

46th Legislature

The committee was called to order at 8:30 a.m., March 20, 1979, by Chairman Herb Huennekens, in Room 434, Capitol Building, Helena. All members were present with the exception of Rep. Fagg who was absent. Staff attorney Randy McDonald was present.

House Bills 303 and 309 were to be heard.

HOUSE BILL 303

Rep. Kenneth Nordtvedt, District #77, Bozeman, sponsor of HB 303, said a substantial amount of inflation is expected into the 1980s. HB 303 would actually adjust tax brackets, standard deduction and income required to file a return on his income based on the Consumer Price Index. Income required to file a return would be 10% higher, standard deduction 10% higher, tax bracket would be stretched 10%. If his income grew by 10% as did inflation, under indexing, his effective income tax rate would remain constant. He would not find himself being taxed at a higher percentage. If he had an income of more than 10% over the consumer price index, he would have to pay more tax, but would not be forced into a higher bracket if his income was even with that of inflation.

On page 2, lines 18-21, is shown the calculation of inflation factor based on the June consumer price index for the taxable year divided by the consumer price index for the preceding year.

Each year the Department of Revenue would figure tax brackets by multiplying the bracket amount by the inflation factor for that taxable year and round the product to the nearest $100. The resulting adjusted brackets are effective for that taxable year and shall be used as the basis for imposition of the tax. See Page 5, lines 16-22, of the introduced bill. This would keep tax brackets up with the inflation factor. Personal income inflation would maintain its real purchasing power.

The inflation factor for that taxable year shall be multiplied by the minimum amount of gross income necessitating the filing of a return for that taxable year. These adjusted amounts would be effective for that taxable year, and persons having gross incomes less than these adjusted amounts are not required to file a return.

Indexing all variables means the structure of the tax system would be maintained. A handout showing what happens without indexing and with indexing was passed out to the committee. Many dollars are being taxed in a higher bracket because of inflation. There is an automatic real tax increase going on with inflation. Gross income went up 10% last year. If income grows the same as inflation, so does the tax. Under indexing, income stays the same as far as purchasing power.

HB 303 is endorsed by the National Taxpayers Association. Intergovernmental Relations has urged the federal government to consider this type of taxation. Without taxing we are increasing real taxes each year without any vote by the legislature. See attached for more information.

Ed Nelson, Montana Taxpayers Association, Helena, gave the committee members two handouts regarding income taxes and inflation in the present U.S. economy. You will see a very significant growth in income tax in the state he thinks. Government has gained windfall revenue from the inflation. In order to have a strong private economy, we have to have a strong economic framework in which to work. Martin Feldstein, in his attached article "Income tax inflates with U.S. economy" asks where did government get its money? It doesn't come from the tooth fairy - it comes from the taxpayer."

Janelle Fallan, Montana Chamber of Commerce, surveyed members in November regarding matters of most interest to them. Unemployment taxes rated high; personal income taxation came in the higher brackets. Supports HB 303.

Gerald T. Neils, Montana Logging Association, Helena, is also a broker on the New York Stock Exchange and the Chicago Board of Exchange, and heartily endorses the idea of indexing. In 1954-5, calves were selling at 11-13¢ average for 508# animals - at this time the same animals would bring about $1. The New York Stock Exchange rates it about 850, finds its way into the commodity market which does a great deal more business than any other. The velocity of money is way up. Can insulate the Montana income taxpayer where some action is taken at the federal level where we cannot touch. Commodity prices immediately took off when a decision was made not to finance. Copper prices had reached a level of 63¢/lb, and since 1963 have never been below 63¢ and have reached as high as 94 5/8 and 1.43 on the London Metal Exchange.

Prices traded on the Chicago Board have all moved up and these prices are already reflected on everything that you buy. Can't do anything about the actions of the open market committee of the federal reserve. Whatever interest rate you can get you can find out how long it takes to double your money and also how long it takes to depreciate the money. The inflation rate of 7.5% is easy to figure out to learn what is happening to the money. If we don't index, we are going to be forced to pay excessive taxes. At the rate that inflation is going, after the 3¢ stamp was replaced by the 4¢ stamp, it was not long until now it is 15¢. Do you think the postoffice has stopped printing stamps in higher denominations for first class letters?

OPPONENTS: None

Rep. Nordtvedt closed saying when indexing first started to be popular, people thought that during a year of inflation, they would have more money to spend. If you indexed, you would deny the government inflationary revenues for their expenditures. Properly structured indexing allows the government a revenue that is equivalent with what it should get because of inflation. Indexing has been studied by economists in the country. A flat income tax system does not need to be indexed. Whether your dollar income is inflated or not, you pay the same. This is why a corporation tax doesn't get raised by inflation. Personal income tax is the same as corporation license tax. By multiplying 1.5% growth, you would predict 1.5% increase in personal income tax revenue.

There is a long defined notion that income should be taxed on a graduated basis. There are two trends: one is inflation and the other real productivity growth which makes for faster income growth. Under this that part of indexing continues. This is to technically allow indexing on that part of income that is increased because of inflation. There are 7 countries using indexing now.

Rep. Hirsch commented to Rep. Nordtvedt that you have a point in that the taxpayer shouldn't shift that burden completely onto government and they cannot expect windfall profit from the taxpayer. If you had a 10% inflation factor, maybe some middle ground would be more appropriate whereby the government and taxpayer assumed a share, say 5%. Rep. Nordtvedt said under indexing the state does not get hit at all. If there is a 10% inflation, the government gets its 10% inflation - they just don't get the windfall revenue.

Rep. Fabrega asked what year would be used for a base year? Rep. Nordtvedt thought June of 1970. If the exemption figure is changed, indexing can be wedded to any other income tax measure. If HB 303 is passed, indexing would start January 1, 1980. By using June of 1970, base would become 1967.

Rep. Sivertsen asked about using the consumer price index in determining the inflation factor. Rep. Nordtvedt proposes that the inflation factor be defined as the consumer price index for June of the taxable year as divided by the index figure of the following year.

Rep. Sivertsen is concerned about the rate and the growth of government because government adds to this inflation rate and is it also true that under indexing if we add that inflation factor that could mean less money to state government because there is going to be fewer taxes collected and maybe this, in effect, is going to help reduce state spending?

Rep. Nordtvedt said divide state revenue into two portions - inflationary and windfall revenue, and if we don't index, we will have constant increase in windfall revenue through the 80s.

Rep. Huennekens asked Rep. Nordtvedt if he had any problem using the urban CPI in a state that is largely rural. Rep. Nordtvedt said by dividing the CPI of one year by the CPI of a preceding year, the ratio is very sensitive to which CPI you use. It has some regional variations in the level, but it is growth that shows up relative to the base year. Use the one most readily available and most commonly known as a measure of the nation.

Rep. Huennekens said that has a 1967 base year. What effect will that have on your application with a base line of this July 1. Rep. Nordtvedt said by using a base of 210 in 1980, and the base in 1981 was 232 - 232 divided by 210 would be the factor used since it would show growth rate in the past year. The 1967 base year has no relevance here.

Rep. Underdal asked, by using one month for a base, why not average 12 months and use that as a base. Rep. Nordtvedt explained that when dividing one tax year by a base year, if you averaged over the year, you would get a consumer price index. Divide the taxable year CPI by the base year CPI and you get the inflation factor needed. By picking June, the Department of Revenue has the necessary information in August to put information on tax forms.

Rep. Reichert asked Howard Vralsted, Department of Revenue, if it would be much more work or cost more to use this method on income tax forms. He advised her that forms are printed every year anyway.

The hearing was closed on HB 303.

Rep. Nordtvedt, sponsor of HB 309, said this bill is entirely separate from HB 303. There is no way to increase a man's wage without increasing productivity. HB 309 is an attempt to try to bring some sense into the computation of business income. He explained the handout (attached) wherein inflation figures show much more than what the "real" gain is. Capital gains should now be taxed only on the true gain and not on the dollar gain. Every year a dollar is a different entity.

HOUSE BILL 309

Page 2 shows what happens in interest gains when interest rates are less than the inflation rate. If you do not receive interest that is at least the same as inflation rate, you lose "real" money or purchasing power.

Proper treatment of depreciation allowances shows the difference in real depreciation dollars when inflation factor is considered. He explained the handout in detail.

You have to make comparisons with money made in previous years with what is made in the present year. When the value of the dollar does not change, it is simpler, but under inflation the 1977 dollar is an apple and the 1978 dollar is an orange. HB 309 converts apples and oranges so you can make a reasonable allowance. Present taxing system is encouraging debt and not making savings worthwhile; and is grossly overtaxing capital gains; is not properly allowing you depreciation.

Gerald T. Neils, Montana Logging Association, said the business of logging is a very capital intensive business. It costs thousands of dollars for equipment with which to log. You have an investment in any account of over $100,000. Depreciation schedules are totally inadequate, money for new machines has to come out of capital. He heartily endorses the passage of HB 309.

Janelle Fallan, Montana Chamber of Commerce also supports the bill.

There were no opponents.

Rep. Nordtvedt felt no need for a closing statement.

Questions from the committee -

Rep. Sivertsen thinks the method of computation is going to require the use of an accountant - would this be done on the state level? Rep. Nordtvedt would want to make sure that the computation in HB 309 is not confused with that of HB 303.

Hearing on HB 309 was closed and the committee went to Executive Session.

HOUSE BILL 916 - the question of whether a bill changing "officer" of a corporation to "president of corporation" be liable for unemployment and other money withheld from an employee that is not paid to the state is the subject of concern to Mary Craig, Director of the Department of Revenue. The committee has to decide if a committee bill is to be introduced.

HOUSE BILL 910 - Rep. Mel Williams moved HB 910 DO PASS. After some discussion, HB 910 Do Pass motion was adopted unanimously. Rep. Fagg was absent.

HOUSE BILL 915 - There is a great fluctuation in the cash fund when huge payments are made to the school foundation fund quarterly. In the past this has been handled by borrowing from other funds if there was a deficit. The drawdown will hit each quarter. In March 1978 the fund was a minus $15 million. In 1979, it is predicted there will be a $40 million deficit and in 1980, a $45 million deficit. In the past this has been handled by borrowing from other funds. The short-term investment portfolio draws from 10 to 11% interest.

When the state borrows that money to place in the cash fund, we lose that interest. The proposal you have before us in 915 is that the state issue and sell notes in anticipation of taxes and revenues appropriated for expenditure during a fiscal year. These would be tax-free because they would be sold at a lesser interest rate. By doing this the state would save the loss of approximately 10% which would accrue in the earmarked funds from which the state borrows. They would be drawn so as to provide every protection to keep the state from becoming an investment organization. Acceptance of this as a committee bill was proposed by Rep. Huennekens.

Rep. Sivertsen asked if this deficit was because of accounts receivable.

Rep. Huennekens said the state gets a tremendous surge in revenue when income taxes are paid. The state usually borrows from short-term portfolio to pay when there is a deficit in the school foundation fund. Tax anticipation bond route seems to make more sense than borrowing from other funds.

Rep. Bertelsen asked if there would be some kind of income loss when tax-free bonds are sold. Rep. Huennekens said they frequently go to the Minnesota market so aren't losing much income tax.

Rep. Fabrega said siphoning off $50 million and losing 10-11% interest, the general fund loses $3 million as you draw it down. We are definitely saving that $3 million we would otherwise lose. You can borrow at 5% and collect at 10-11%. All warrants have to be paid at the end of each fiscal year.

Rep. Dassinger mentioned most of the bonds sold for housing authority are sold to New York and therefore income tax that would not be paid would be federal income tax. Rep. Fabrega said insurance companies are one of the heaviest investors. All of the companies are at the 48% federal tax bracket level. These bonds have quick cash provision and are free of federal tax. Bonding companies will probably require each legislature to validate this.

There was unanimous acceptance of this proposal as a committee bill. It became HB 915.

HOUSE BILL 909 - Rep. Lien opposes HB 909 since all income is all taxed again as personal income.

Rep. Huennekens suggested that if it is agreeable to the committee, HB 909 be proposed for study by the revenue oversight committee. Rep. Fabrega agreed. Corporations are taxed on income at 10.8% while personal income tax is at 46% of income. A graduated system that would give small business a break should be considered. Also take a good look at any that might have the ability to monopolize. He would be in favor of adopting this and then tabling it for further study.

Rep. Dassinger suggested studying the corporation tax using 7% figure.

Rep. Williams opposes any increase in the license tax for all corporations. He feels the approach to a graduated tax similar to the graduated income tax should be studied. He wants to take into consideration the inventory tax some corporations pay.

Rep. Sivertsen said let's not take and monkey around with 150 and if the committee wants to raise more income, do it in a separate bill.

Rep. Fabrega feels there is a need for a fluctuating schedule.

On the motion to accept HB 909 as a committee bill, the motion was adopted. Rep. Fagg was absent. Reps. Burnett and Underdal voted No.

Rep. Lien moved to TABLE HB 909. Motion carried with Reps. Dassinger and Johnson voting No.

HOUSE BILL 912 - Rep. Fabrega moved HB 912 be accepted as a committee bill. There was unanimous acceptance. Rep. Fagg was absent. Action on HB 912 is to be deferred for awhile.

HOUSE BILL 213 - Rep. Williams moved that agriculture equipment be established in Class IX, business inventories and unprocessed agricultural products in Class V at 4%. Class V is divided into Classes V and VI. Business inventories unprocessed agricultural products are in Class V at 4%. This is offset by heavy large machinery being in a higher class.

Rep. Nordtvedt voted No on the amendments. Rep. Williams moved Do Pass on the amendments.

Rep. Lien wants livestock held for sale to be in Class V at 4% - breeding livestock would remain in Class VI, and he asks that this definition apply for income tax and capital gains purposes. Rep. Fabrega would go along if all breeding stock is put in Class VII at 11%.

Rep. Nordtvedt thinks a compromise should be reached. He is against the motion.

The meeting adjourned at 11:15 a.m.

Herb Huennekens

REP. HERB HUENNEKENS, Chairman

Jo Lahti

Secretary