HOUSE TAXATION COMMITTEE

46th Legislature

The committee was called to order by Chairman Herb Huennekens, District #88, Billings, at 9:15 a.m., January 18, 1979, in Room 434, Capitol Building, Helena, Montana. Staff attorney Randy McDonald was present. There was a quorum present.

Bills to be heard were HB 150 and 141.

HOUSE BILL 150

Rep. Fabrega, sponsor of House Bill 150, advised that the banks thought the state had no right to tax that portion of the capital investment of the banks that was invested in federal securities, which leaves almost no value to tax. Really banks are corporations doing business in Montana and they should be treated as all other corporations. One of the problems that existed again was that if the state does not tax its own securities, it could not tax the securities of the U.S. Banks hold tax-free paper. HB 150 would change that tax-free status and make income from such securities taxable for all corporation holders.

It allows the State of Montana to tax all of the income of banks whether from state obligations or from the corporate license tax. Banks will now be taxed on their net income with some exclusion allowed for bad debts at the rate of 6 3/4% which all other corporations pay. The next problem was that the bank share tax went to local governments as part of the value base and we are removing a sizeable chunk of money from local governments. Unlike other corporations, the corporate license tax is collected by county treasurers. The distribution is made based on that proportion of the millage that belongs to each district. The amount of revenue that is derived is to be divided in an exact formula in relationship to the school district, city, and county. The method of distribution of income collected would not be changed.

This bill would - 1. Do away with the tax-free status of municipal and state obligations. Banks are agreeable and since they are the major holders of municipal and state obligations, it would be acceptable to them.

John Cadby, Manager of Montana Bankers Association, said 160 banks support this idea and have agreed to support this measure. The objection has been in trying to reach tax equity, and their conclusion was that net income was probably the fairest means of taxing banks and since they are a profit-making organization, it would be fair. HB 150 achieves that end and taxes them as is any other corporation. The bank share tax was very discriminatory.

Harold Pitts, Montana Bankers Association, and George Anderson, certified public accountant, representing Montana Bankers Association, suggested we should try to find out what the effect would have been if the banks had been under the corporation license tax. None of the banks would pay any bank share tax under the old law. We will not challenge the bank share tax law. We are operating under the 1977 law. $5.5 million was paid in bank shares tax during the last two years. What would have been collected under the 1979 bill from

160 banks net income if all banks in Montana had paid the corporation license tax had this bill been in effect in 1978? $5.6 million would have been paid, and this amount would have gone to local governments. All Savings and Loans taxes would have added another $5 million. The municipalities and local governments will receive about the same amount of dollars under HB 150 as under the bank shares tax method.

Ross Cannon, representing the Savings and Loan Associations, recommended amending HB 150. He presented a detailed history of bank taxation, which he described as being bizarre. He agreed with the banks that taxation of moneyed capital is wrong here. He does not quarrel with the principle of revising the concept. However, the S&L Associations are the only class of financial institutions within the perimeters of this bill whose taxes significantly increase as the net result of HB 150, and the reason is that all financial institutions invest in government securities. There is very little tax on moneyed capital. Government obligations were not taxable. Courts held expressly that the taxation of government obligations are not taxable.

The banks suddenly looked at this and litigated since no financial institution is now legally liable for any form of property taxation on any government obligations. This bill proposes to remove the tax exemption from state and municipal obligations and thereby renders the obligations of the U.S. taxable for income tax purposes on income derived from such obligations; and for purposes of applying the corporation license tax. Banks are out from under the bank share tax and therefore their taxes are significantly reduced. Some larger banks received a tax reduction of thousands of dollars. S&L taxes will go up about 53%. There are 16 home offices for 16 S&Ls and 160 banks.

There is no tax on credit unions - federal law prohibits this. The only financial institutions to which this would adhere are the S&L Associations. That isn't quite tax equity. Taxes go up, bank share taxes go down. Compared with the 1976 income tax, this law reduced the net yield over $6 million, so the net yield to local governments is down about $2 million. $1 million comes from the state revenue sharing. This would have a significant revenue effect.

S&Ls are paying a very high price for money. He thinks the S&Ls should be allowed to have a reserve for bad debts to permit these financial institutions to shelter a portion of their net income, ameliorating the impact of this bill in this manner. It would help the S&Ls by allowing them to have a counterpart in bad debt reserves.

Paul Johnson, President of S&L Association in Great Falls, said HB 150 makes incomes from government obligations taxable. They don't hold any municipal bonds. It would increase Subchapter S corporation license tax 94%, based on taxes paid in 1977. He feels this is too much of an increase. If the amendment is adopted, it would increase net tax about 20% instead of 94.4% which is nearly doubling taxes and is too great an increase.

Steve
In 1976, the effective tax rate for commercial banks was 15% whereas the effective rate for S&L was 26%. He agrees with the amendment offered, and supports Cannon's testimony.

Einor Long, Savings & Loan in Havre, concurs with Ross.

Ernest
witnesses, and with Ross. He feels it is an excessive increase in taxation.

Fred Flanders, Montana Independent Bankers, Helena, confirms Mr. Cadby's testimony and supports his testimony.

Dan Mizner, Executive Secretary of Montana League of Cities and Towns, recommends an amendment on pages 11 and 12, and on page 12, line 2, by inserting "if it is generated from that town, it should be returned to that town."

Dean Zinnecker, Director of Montana Association of Counties, doesn't know just what effect HB 150 will have. He wants to see a fiscal note. It is questionable as to what effect a bill supported by 160 banks will do to the counties. Bankers show about a $300,000 impact so am not sure just what effect it would have on counties. He questions the fact that the assessing is inequitable or not. Regarding the court case, it is hard to determine what the percentage of the capital of banks is in federal obligations. If counties lose the stable property tax, they will be forced to rely on an income tax which would cause a fluctuating mill levy. Budgeting to pay taxes would be very hard. It would cause some redispersion problems. If the tax base is lost, they are likely to go out of business. He wants to know what effect HB 150 would have on taxes collected.

There were no specific opponents.

In closing, Rep. Fabrega said one of the things that was not made clear, is the fact there was greater variation in the amount paid by banks even if similarly taxed. Where banks invested their funds varied and created a problem. Twin operations showed 30 times difference between the way the bank share and corporation license tax worked; S&Ls actually escaped taxation in Montana. It was not in the best interests of Montana. There is no reason to give an incentive to send Montana money on to Washington. There is a revenue drop because we allude to a mythical figure in the 1976 tax. It was paid under protest and the banks won the case and it will have to be refunded. A $6.6 million tax that was levied, but was not paid.

With regard to Cannon's amendment, Rep. Fabrega feels it should be considered. An increase is generated by the fact that S&Ls are not being treated in a similar way to the banks and they should be allowed that deduction for a bad debt reserve account. There is no such thing as branch banking in Montana. On S&L branches in other counties, the Department of Revenue would determine how much of their earnings came from a certain district and that amount of money should be returned to that district. The committee will attempt to come up with more exact language.

Regarding Mr. Zinneckers testimony - there is fluctuation of mill levies because local governments have always operated on the property tax base. Testimony pointed out that there has been a constant growth in bank income. Fluctuation concern should be minor since a slight growth would make for greater revenue to counties.

Questions:

Ross Cannon was asked for monetary figures providing data with regard to the amount of tax under 1978 tax laws that would parallel what Mr. Anderson had. Mr. Cannon said he has asked what the actual corporation tax would be including income from the S&L based on the same year, but the data is incomplete.

Rep. Huennekens asked Mr. Cannon for monetary figures. Cannon said the 16 S&Ls paid $472,764 in 1976. Under HB 150 based on 1976 figures, taxes would be somewhere in the area of $.5 million.

Rep. Fagg asked if it is possible to equate banks and S&Ls - is there a common denominator on which to figure earned income if neither use reserves. Mr. Anderson said there is a difference. They both have a reserve for bad dets. HB 150 does not allow the utilization of a bad debt reserve for figuring tax - many, many corporations use a reserve for bad debts but the corporation license tax does not allow that, and they have to take that reserve out, so banks deducted out what they had written off only. Under the corporation license tax only the amount actually written off as bad debts can be deducted. A reserve for bad debts account would be much higher than actual charge-offs.

Rep. Fagg feels the difference between writing off a bad debt reserve and banks using an actual bad debt write-off figure would make for equity. Banks would love to keep the bad debt reserve they now have.

Rep. Sivertsen asked Mr. Cannon to explain to the committee why he thought S&Ls should be treated differently. Mr. Cannon said they don't wish to be treated differently. He thinks the bill in its present form does that. S&L taxes go up and bank taxes go down. He thinks it is alright for banks to use a bad debt reserve of 1.2% of loan value. The net effect of this bill in its present version reduces $6 million tax to $1/2 million. Our S&L taxes go up and bank taxes go down. The reserve technique effects a reduction of $100,000 of net pre-tax income. Without share tax banks' tax liability goes down. S&L taxes go up because government obligations' incomes are not added to income for corporation license tax.

Mr. Cannon said federal law insulates credit unions, etc. All kinds of institutions are affected by this tax. Rep. Sivertsen asked if, by IRS rulings, it would be constitutional if we treated S&Ls differently. Mr. Cannon answered constitutionality is a function of the courts. S&Ls exist so that funds will be available for providing funds for housing.

Mr. George Bennett, attorney for Montana Bankers Association, proposed that since only the S&L taxes would be higher than other institutions, they be allowed to deduct a bad debt reserve.

The law is clear. Corporation license tax on similarly situated corporations cannot be different. The question is would you be treating them differently in allowing one to have a higher tax reserve than others?

The bank share tax or moneyed capital tax on financial institutions was a property tax. S&Ls and banks are similarly situated in that they pay taxes on buildings and furniture and fixtures. They were taxed on the net worth of

of the financial institutions. Bank worth was represented in large part by government obligations. The corporation license tax was a tax on all corporations. Specific organizations for religious and educational purposes were carved out. Bankers have felt that they, as a business corporation, were b e ing discriminated against. There have been three redrafts of these regulations, four lawsuits over the bank share tax. Now it is illegal to attempt to reach government obligations. If you are going to treat the S&Ls differently, it would seem you are discriminating. Is their bad debt any different and should be treated differently? If you zero in on financial institutions which are competing with banking operations, they should be treated similarly. The S&Ls had been deducting for a bad debt reserve before the turn of the century while the banks were not. The S&Ls have enjoyed a favored tax status for many, many years. Hope that you are not going to eliminate that discrimination.

Rep. Lien asked if a reserve for bad debts is in excess of actual bad debts. The S&Ls computed it on a formula of 2.7% of outstanding loans no matter what their loss experience had been. They have been reducing their bad debt reserve, and have been adding part of it to their income since the loss experience has been slight. Now, corporations will be able to charge off only actual losses. In fact, banks are bringing back into income figures amounts they set up in reserve accounts 5-10 years ago. Rep. Lien feels that at some level the money should be pulled back into income.

Mr. Bennett advised the amount of loss was based on the amount of loans outstanding at the end of the year by banks.

Rep. Williams said the purpose of HB 150 was to create equity for financial institutions taxation. When interest income from government obligations is not taxed, there is no equity. Under HB 150 they would all be taxed the same and this would make for equity in taxation.

Mr. Cannon thinks the bank shares tax was inequitable. Essential immunity of state is based upon a federal prerogative which says U.S. institutions can't be taxed is where this principle of not taxing government obligations arose. Taxation of governments is not permitted. The effect of this tax is to shift their share of that onto S&Ls and other financial institutions.

Rep. Nordtvedt asked since taking this tax-free status of some of your bonds away, have you made any estimates of how your interest rates might go up on the bonds you sell? Mr. Mizner said the bonds would be very hard to sell.

Rep. Johnson asked Mr. Cannon if any S&Ls would have to be closed down? Would it raise the rates of interest? Mr. Paul Johnson said they have been accorded a bad debt reserve for their mutual institutions. Congress has given us this little vehicle because we are dedicated to providing homes for the people of the U.S. We can't charge 18% as is done on bank charge card accounts. Interest rates probably won't be reaised. Money rates are up now and so interest rates are up. We would have to pass the higher rates along to the users.

Rep. Fabrega asked if they see the reserve fund of a S&L being of a different nature because of the nature of your lending? Mr. Cannon read an excerpt from the tax act of 1969 which allowed S&Ls to use bad debt reserves because of the nature of their lending function since much of their lending was done for residential improvement.

Rep. Fabrega remarked besides it creates more funds for housing since they provide about 80% investment in housing. They might need to create a greater fund than that of a bank. It was brought out that this is the basic difference between banks and S&L associations. Because of their long-term lending, S&Ls cannot adjust to economic conditions as easily as banks with their bigger ratio of short-term loans. The S&Ls want a bad debt reserve since it provides more money for housing. Did S&Ls ever pay anything like the bank shares tax did? If so what was that and when did you quit paying that?

Mr. Cannon said an organization is taxed in accordance with the type of property it has.

Paul Johnson said S&Ls have paid the corporation license tax. Banks and S&Ls have all been treated equally under the corporation license tax. Federal law provides that a state may tax the income of federal corporations on an income or franchise tax. It was determined by the Department of Revenue since municipal bonds were exempted, it could not tax the interest from U.S. obligations and still have a non-discriminatory tax. The S&Ls discovered that they didn't have to pay equivalent tax as the bank share tax. Banks always allowed deduction of the value of government obligations.

Rep. Williams said S&Ls are non-profit corporations. All they would have to do would be lower their reserves.

Mr. Johnson said there is a small profit motive since they have to set aside a certain percentage of money - 5% of their loans must be maintained for the safety of their depositors.

A subcommittee was appointed to study HB 150. Rep. Lien, chairman, Reps. Sivertsen and Williams. Rep. Fabrega was to act as a resource person.

Rep. Nordtvedt, sponsor of House Bill 141, said this bill changes the license fee and various types of classes for public contractors who engage in bidding on public jobs.

HOUSE BILL	Opponents:
141	Rep. Fagg asked what qualifications of the various types of licenses were required.

Bob McGee, Department of Revenue, said the basic qualifications of any of the licensees is that they submit a financial statement. Anyone who can obtain the necessary bond can apply. Qualification is not related to experience.

Rep. Fabrega asked if you have to somewhat justify your level in business over a period of years. If you are not doing enough business to be able to use a class A license through experience, you would have to submit a resume. Then you would be dropped to the next lower class. Mr. McGee said his office has never suggested that - most of the contractors pick that out on their own. If you change your class of license, you must obtain a new license. Might as well stick to the class contractor is already in.

Rep. Underdal asked the reason for asking higher license fees. Is this department funded by these license fees? No, that comes out of the miscellaneous tax division. Moneys are distributed by statute. They do not operate on license fees. Mr. McGee said the reason for raising the fees was to keep in line with the inflationary influences. If the contract limitation was raised, he felt the fee should be raised. The fees were first set in 1959. A contractor has to have a contractor's license to bid on anything paid for by taxpayer money.

Laurie Lewis, Acting Director of the Department of Revenue, advised the legislature has raised fees for many other licenses, and he felt it appropriate to do that here.

The hearing adjourned at 11:45 a.m.

Herb Huennekens
REP. HERB HUENNEKENS, Chairman

Jo Latta
Secretary