

HOUSE TAXATION COMMITTEE

46th Legislature

The House Taxation Committee was called to order by Vice-Chairman Ernie Dassinger at 8:30 a.m., in Room 434, Capitol Building, on March 30, 1979. Reps. Gilligan, Hirsch and Vinger were absent. Rep. Vicki Johnson was excused.

Bills to be heard were Senate Bills 265, 477, 508, 521 and SJR 5.

Senator Thomas E. Towe, District #34, Billings, Chief sponsor of SJR 5, explained this is one of two resolutions which came out of the Coal Oversight Committee. One of the directives made to the

SENATE JOINT Committee was to review the investments of our trust funds.
 RESOLUTION We looked at a large number of funds that are invested to
 5 see if there was some way to better use them without affecting
 the rate of returns and the security. It came to our attention
 that there is a secondary market for federally guaranteed Small Business Administration loans. The typical of these is guaranteed to 90% and the other 10% is the risk of the loaning institution. The secondary market is the purchasing of the 90% guaranteed portion. In Small Business Administration loans the money is loaned by the local bank--they come up with the depositors' money to make the loan. When they sell the 90% guaranteed portion as a secondary loan they have the proceeds to reinvest in another loan and so this would be extra capital into the community. This is very effective and beneficial for the local community. Since the loan would be 100% guaranteed by the federal government, there is no risk and the rate of interest is high--11% now. Why can't the Board of Investments invest some of the state money that way? The problem is the Board wants to review each and every loan to see that it is a good loan. This takes a lot of time and the banks say to heck with it. That is what this bill is addressed to. This resolution simply suggests to the Board of Investments that the Legislature urges the Board to modify its policies with regard to SBA loans. The resolution would ask the Board to actively seek out and purchase more of these loans. The Board of Investments has invested about 85% of all the money outside the state of Montana, and we should be putting more of that money to use here.

John Cronholm, Small Business Administration, said they welcome the opportunity to appear on this bill and they strongly support the legislation and urge favorable consideration. He said we are living in an equity poor state with a limited supply of funds and a great demand for those funds. The selling of these guaranteed loans is an important tool to the banking community and the small business community of Montana. Our activity is accelerating as there were 225 loans in 1974 worth 15 million and 511 loans in 1978 worth 57 million. Part of the cause of this strong and steady demand is the secondary money market which at the present time is attracting outside money. We aren't sure how long we'll be able to attract this outside money and the banks need to be assured of this secondary market. It will be a gain to the state if there was a greater commitment of the Board of Investors--the funds would then be available to finance ordinary growth and expansion.

Paul D. Caruso, First Security Bank, Helena, said he had served on the Board of Investments for six years. He said he left because he got tired of bureaucracy. It was the policy of the Board then to make as many real estate loans as they could, but now the Board has gone into another type of investment--common stocks. They feel they can make a better rate of money by shipping the money out on a short-term basis. The change should be made to having the money used in state even if it has to be mandated by law. If we build a better tax base it creates not only business loans but a tremendous amount of real estate that would enhance a better tax base. He endorsed the resolution.

Senator Towe closed and there were no opponents to the bill.

Rep. Bertelsen commented to invest in Montana we would lose a small amount of earnings. Senator Towe said he would refute that. SB 58 said invest in Montana even if it meant a loss of revenue. This bill is different. He said it is conceivable that some investments might not pay off as well, but it is also conceivable that it could pay off better with SBA loans. There is less than 9% earned on the average and these are loans at 11%.

Rep. Williams said the use of the "prudent man rule" is the reason most of the money has gone out of the state of Montana. Senator Towe said even if bound by the "prudent man rule" it doesn't mean they couldn't invest in these SBA loans. The "prudent man rule" is what would a prudent investor invest in under the circumstances. Mr. Caruso said he didn't agree with the point of the "prudent man rule." He felt the Board wasn't addressing it when they bought common stock which returned 5 to 5 1/2% when they could get returns of up to 10 1/2% on these loans. Even if the stock showed a gain--the Board didn't usually sell the stock for the gain.

Rep. Underdal asked if they were just talking of investing school trust funds, coal tax funds and this type of long term investments. He asked if investments sent into the Trust and Legacy Fund weren't limited to the type of investments that could be made. The reply was this had been changed--anything on a guaranteed basis like these loans would fit into these investments also.

Mr. Caruso mentioned there was an actuary study every three years when he served. He said the investment funds in the teacher's retirement fund was invested so well they gave each retired teacher 13 checks instead of 12.

Rep. Reichert said generally resolutions do not appeal to her because they just urge, but noticed this says the Board would actively seek and ask for a report to the legislature. She asked why a resolution and not a bill. Senator Towe said they should be doing this under existing law and there is no need to clutter up the statutes. He felt it was better to gently suggest to them what they should be doing rather than mandate them.

Rep. Lien asked what the administrative fee to the institution would be on SBA loans. Senator Towe said the maximum rate a loan can carry is 12%, and when they quote a rate from a purchaser these quotes can range from 10% on up. The net yield to the purchaser is probably in the area of 10 to 10 1/2% and that takes care of the administrative costs and service fee. John Cronholm said the SBA charge the bank 1% for the insurance on the guaranteed portion.

Rep. Sivertsen said the Board of Investments is required to invest the money for the maximum yield of interest. He asked Senator Towe if he felt that perhaps the Board of Investments was overlooking these SBA loans for any other reason than that. Senator Towe said he didn't think they could get a guaranteed loan for above 10% so the returns from these loans would be better. He said the policy of the Board is to individually review and analyze every single loan for credit worthiness. By the time they request all the information the bank says forget it. They should be able to simply call the bank and ask if they have any loans they want to sell. The Board can say send us an indication the loan is guaranteed and we will buy it.

Rep. Dassinger mentioned the Board has made as high as 13% on their investments. Senator Towe said it was a short term loan perhaps.

Senator Lawrence G. Stimatz, District #43, Butte, chief sponsor of SB 265, said in August, 1977, our Montana Supreme Court in a case of the State vs. Grace C. Bear changed the law that had been in effect for
SENATE BILL thirty years in regard to the deduction concerning inheritance
265 tax. In a case of joint tenancy the court said the total
mortgage comes off the top before the property is divided
in the joint tenancy. Prior to this only half the mortgage
would be deducted. This results in less tax for the state of Montana.

Tom Stohl, Administrator of the Inheritance Tax Division, said the bill is designed to correct an inequitable decision. Property valued at one million has ended up not paying any inheritance tax due to this.

There were no opponents and the Senator closed.

During questions it was brought out by Mr. Stohl that it is quite advantageous to go out and borrow money to circumvent the law. In the case of solely owned property the full amount of the loan is deductible. The law would apply to tenants in common but not to true partnerships.

Senator Tom Hager, District 30, Billings, chief sponsor of SB 477, which is at the request of the Department of Revenue, deals mainly with absentee property as shares of stock, but not limited to that. Senator Hager went
SENATE BILL through the bill explaining the changes.

477 Tom Stohl, Administrator of the Inheritance Tax Division, said this is primarily a housekeeping bill. It is attempting to relieve known problems and save the state money. If the owner does not come forward in some way in seven years, the property is considered abandoned. If it involves more than \$50 in value (used to be \$25) it is published in the paper. In the case of a voluntary dissolution of a corporation it is said to be in effect on the date of the dissolution rather than later, as later there is no one around to be held responsible. A bank is required to send notices to its depositors and if they come back addressee unknown they advertise, check with relatives, etc., and if the notice is not returned it is presumed to have reached the owner. Abandoned stocks can be sold on the stock market rather than put up for bids with this bill. There is no time limit in which to recover property.

Rep. Reichert suggested some old stocks may be of value for historical reasons whereas cash value may be negligible. The Historical Society might appreciate them.

The committee adjourned to executive session.

Rep. Williams moved SB 265 BE CONCURRED IN. There were no Noes. Representatives Robbins, Gilligan, Hirsch, Lien, Vinger, Huennekens, Johnson were absent. Motion carried. Rep. Harrington will carry the bill on the House floor.

Rep. Burnett moved SB 477 BE CONCURRED IN. There were No Noes. Representatives absent were the same as above listed. Motion carried. Rep. Burnett will carry SB 477 on the House floor.

The committee resumed hearing bills since sponsors were now present.

Senator John Manley, District 14, Drummond, explained SB 508 is just for the purpose of updating inheritance law of the State of Montana so it is approximately the same as the federal law. In 1977 the federal inheritance law was rewritten and passed, making it quite a bit easier for the inheritance tax or estate tax to be paid. It allows the family farm and businesses to be valued on production, and it allows the tax to be paid over a 15-year period. It is a rather complicated piece of legislation. He offered amendments to clean up the wording of the bill.

Fred Johnston, Augusta, has a law degree and has done quite a bit of both state and federal estate tax work. He feels he is quite familiar with Montana estate tax and the federal tax. These taxes impose an extreme burden on small businesses and ranches. The House Ways and Means committee in 1976 had occasion to consider the problems of the federal estate tax. He read from the committee reports with respect to the valuation of property.

Your committee believes that when land is actually used both before and after the death of the owner for family farm or small business purposes, it should be valued as such for estate purposes, instead of the valuation being made on the basis of the highest and best use which may result in the imposition of substantially higher estate taxes. The greater estate tax burden makes continuation of the business not feasible because the income potential is not sufficient to enable payment where the valuation of the land does not bear a reasonable relationship to the income.

In addition, the Ways and Means Committee considered the burden of the ways of paying the tax. The Internal Revenue Service has been historically opposed to giving any extension of the payment of the tax. A substantial portion of the assets of family-held businesses consist of closely held business or liquid assets. In many instances, farm or other business has to be sold to pay inheritance tax. Moreover, some businesses are not so profitable to be able to pay both federal and state inheritance taxes, so a substantial portion of the estate has to be sold.

Rep. Harrington took over chairmanship of the committee since Rep. Dassinger was called away.

Congress recognized it is possible that the business might be sold, so the law provided that the sale, if made within a 15-year period from date of death of owner, would cause the inheritance tax delayed to be recaptured so the extension of payment privilege would not be abused. Therefore, it was

permitted to pay the tax over a 15-year period with interest payments paid during the first 5 years. During the last 10 years, they would pay principal in 10 equal installments. Interest was to be at the rate of 4%. These safeguards were put in so there would not be a windfall. The purpose was to enable continuance of the business.

This type of payment is not required of an estate, but is offered as a choice. If accepted, they provide for a lien against the property or a bond must be provided to secure the tax payment. If there is a sale within the 15-year period, there is a recapture. Executors and heirs can elect this option. These provisions are not limited to agriculture but apply to all small businesses. It was the intention of SB 508 to dovetail with the federal which is extremely complicated. It has been changed to dovetail to the Montana inheritance tax which is exactly like the federal law. It will expedite settlement if the same laws apply to federal estate tax and state inheritance tax. He thinks there will be a lot of times an estate will want to accept this option of electing to pay the tax in installments.

He hopes this will be adopted as it is a tool to help family farms and businesses with estate taxes.

Zack Stevens, Montana Farm Bureau, Farmers Union, WIFE, Cattlemen's Association, urges passage of SB 508.

Mr. Tom Stohl, Inheritance Tax Division of the Department of Revenue, thinks this is the way to go and his office can administer along federal regulation lines which are already in effect. It probably should have a label on it warning this election may be hazardous to your economic health! If the heirs sell out before 10 years, it could be a financial disaster because there would be a rollback of federal estate and Montana inheritance taxes and on capital gains all at once.

There were no opponents.

Senator Manley closed saying you or your heirs have to elect to implement this law and the way you want to settle your estate. Should have a good lawyer and good advice in order to do the best for your particular estate. This is just a vehicle to help people keep their business, and as far as having to pay it, if you elect to go out of business in 6 or 8 years, you would be paying the same tax that you would have paid at the time of settling the estate.

Rep. Fabrega said this bill allows children to continue farming, and if they decide to go out of farming, they will have to pay the state inheritance tax and federal estate tax. This option makes both taxes not to be deterrents to continuation of the business.

Mr. Stohl said there was no fiscal note because of inability to know how many people might want to utilize this option. SB 508 closely parallels the federal act.

Rep. Underdal asked if this option were adopted and it was necessary to sell in a few years, if it wouldn't be very costly. Mr. Johnston said it would be based on the value of the property at the time of death rather than at the

time of selling. When it is sold, there are funds with which to pay the tax. The estate would be subject to a capital gains tax if the land were worth a great deal more.

The main economic advantage to the estate is the low rate of interest on any unpaid tax. Prevailing high rates could be a great burden. This bill is much, much broader than HB 830. SB 508 has this installment feature. SB 508 also provides that passage of property to a grandchild would be the same as to a child. You can funnel money out of small businesses, but the business would still be there.

Mr. Stohl said you are looking at fair market value at the time of death or specific use value at time of selling. Specific use value for Montana - the question of what cost basis do you use on your income tax. Since Montana income tax follows the federal, the valuations should be the same.

Rep. Fabrega asked if there are two valuations that have to be established. Mr. Stohl said basically the fair cash value is the basis - but if that isn't available, they have to look at other means of valuation, and once that is established that would be come the basis for figuring at the time of selling.

Rep. Fabrega said that if this option is elected, the idea of the decedent in a way, is to say 'keep on farming or else pay the tax'.

Senator Manley reiterated that this is not just for farm businesses, but it is for closely held family businesses as well.

Senator Manley, District 14, Drummond, explained this was a committee bill which would increase the time during which a county tax appeal board may meet. There has been a great deal of trouble all over the counties because of re-valuation and assessments haven't got back in time to provide for tax appeal.

SENATE BILL Under current law no protests may be heard after the last
 Monday in June. Under the bill protests could be heard until
521 60 days after the county board has been notified that classi-
 fication and appraisal notices have been mailed to all property
owners.

The State Tax Appeal Board wanted to go out with a tax hearings officer so people wouldn't have to come to Helena, but such a bill wasn't approved, so SB 521 was introduced to state that 60 days after the department of revenue or its agent would have to hear your tax appeal at the county level. This extends the time and has a fiscal note showing the cost. It keeps home rule just a little closer to home.

There were no opponents.

Rep. Fabrega said that you have 60 days in which to file an appeal after the last assessment has gone out.

Rep. Williams said he understands that the appropriations committee wouldn't fund the \$50,000 deemed necessary for STAB to do this. How would this be

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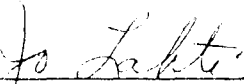
financed by the counties.

Rep. Manley said he couldn't answer right now. This is a county support bill.

Meeting adjourned at 10:30 a.m.



REP, HERB HUENNEKENS, CHAIRMAN



SECRETARY