

MINUTES OF THE SELECT
COMMITTEE ON ECONOMIC DEVELOPMENT

April 13, 1983

HOUSE BILLS 913 AND 915

Chairman John Vincent called the meeting to order at 10:00 a.m. in Room 224A. Representatives Asay, Ramirez and Vinger were excused.

Chairman Vincent requested Representative Hal Harper, the sponsor of House Bill 913, to give an explanation of his bill, and emphasized that as much as possible the discussions relate to policy rather than political considerations, inasmuch as over the next two years the bills are going to be discussed a lot in public and the next Legislature will very likely be dealing with all the bills being considered. He also asked that comments be directed to the relationship between taxation and taxation policy toward economic development.

REPRESENTATIVE HAL HARPER, District 30, Helena, referred to the Fagg-Ellerd bill, House Bill 917, and stated that the portion that interested him in this bill was in the middle of the title, which requires that additional local taxation be through income taxes. If there is ever going to be any progress made on the local level in taxation, it just about has to be through income tax. It seems like most of the parties are in agreement on this particular point. He referred to the Watt concept to replace property taxes from residences with a small percentage flat tax on adjusted income, to close the loopholes. This bill was debated in the House several times and always passed by a very substantial margin, and would die in the Senate. The problem was how the Department could administer the proposals. House Bill 913 allows the County Commissioners to decide whether their county must opt for this local option income tax. The Commissioners could relieve all or any part of the total county-wide mills, and he suggested that it be amended to replace all county-wide mills. The implementation date of the bill would give the Department of Revenue adequate time to lay the groundwork for this transition. When you have crumbling interstructure, sewer systems, roads, you have to develop a healthy economic development, and this approach would solve that problem.

REPRESENTATIVE VINCENT requested that in addressing this bill, the discussion be kept to the property tax and the income tax in relation to this bill and how much we should depend on each one to support government services.

REPRESENTATIVE KEN NORDTVEDT stated that he would try to explain what he considers a "myth" in Representative Harper's bill. He submitted that he feels the property tax burden in Montana has been the one that has become a precedent over the years, and we should entertain ideas of shifting some of the property taxes to income taxes.

He referred to a handout of the ten year trend in property and income tax collections in the State (Exhibit A). The property tax burden has gone down six per cent per Montanan. The ten-year period in comparing the income tax burden, per Montanan, in inflation adjusted dollars, was the one that grew very rapidly; this is up 36 per cent. The graduated income tax system plus high inflation is the statistic that lead to indexing, and the income taxes will not continue to grow faster than normal. He pointed out that according to his research presented that city and county property taxes, per Montana inflation adjusted, when down 17 per cent over that decade. He does not believe there is a crisis in property taxes supporting city and county services. The fast-growing property taxes over that decade was to support schools. If this bill were to pass, Montana would stand out as one of the most income-tax oriented state in the nation. He further stated that he does not feel that city and county property taxes are the basic problem. It is just a more visible tax because of withholding. The public perceives that the property tax is the most burdensome. He summated by stating that city and county budgets primarily do deliver services related to the protection and enhancement of property and, therefore, is probably the most appropriate tax on local governments.

REPRESENTATIVE JAY FABREGA commented that we have fewer pieces of property paying taxes because of the class adjustments, so he wouldn't dispute that. The remaining property picks up the increase, especially in the urban areas where productivity in agriculture is influenced.

REPRESENTATIVE KEN NORDTVEDT stated that the property taxes on homes are not on the high end of the scale nationwide; and, if you look at the fraction of the property tax burden paid by residences, it has consistently been shrinking. The reason is that we freeze the appraisal on homes over the appraisal cycle. It has been personal property that has been taking a bigger share, along with net proceeds year by year.

CHAIRMAN VINCENT stated that in his opinion there is a real problem. He recalled that the levy in Bozeman failed. Several groups there said it was not an anti-education vote; it was an anti-tax vote. Taxes are too high -- property taxes, educational taxes.

REPRESENTATIVE NORDTVEDT stated that people who have no children in school see less connection with property taxes and funding schools than they do paying property taxes and funding their police and fire departments, and city hall, etc. He feels the schools should be funded from the state general revenues.

In response to a question from Representative Vincent whether there would be a difference between a wage earner who is subject to both income and property taxes and someone who is retired and has relatively low taxable income, but has a home, Representative Nordtvedt stated that retired people definitely feel the property tax burden. They particularly feel the impact in their vehicle tax, and this was the one most recently eliminated.

REPRESENTATIVE STELLA JEAN HANSEN stated that property taxes seemed to be the most frustrating tax because people can't do anything about them.

REPRESENTATIVE NORDTVEDT stated that he was really discussing the reality of the different tax burdens, and what has happened to them over the last ten years.

REPRESENTATIVE FAGG suggested doing a study on what has happened on industrial gross proceeds, and residential, and then they can find out different factors of a given area.

REPRESENTATIVE NORDTVEDT agreed and said the biggest correction of the last ten years, the incredible explosion in net proceeds property taxes, this number would even be smaller. We've had an explosion in resource property taxes.

Mike Young, City of Missoula, stated that according to the Conference of State Legislators' pamphlet on taxation, Montana comes out to be somewhere in the middle on taxes of residential property. In some counties they have almost no welfare levy; no general fund levy and he thinks they need to look at this on a regional basis. Urban area taxes may be extremely high on residential property and increasing, and in energy rich areas taxes may be very low and decreasing.

REPRESENTATIVE NORDTVEDT stated that about seven per cent of the homes are in these resource rich areas, so they're not going to influence the statistics much on homes. The top six or eight towns account for almost two-thirds of the people in Montana.

CHAIRMAN VINCENT referred to Senate Bill 94, which he said showed a very dramatic difference in the tax on a home between an energy rich county and other counties.

Leon Stalcup, City Council member, Missoula, addressed the committee and stated that House Bill 913 would not only affect counties, but would affect city taxpayers. He agreed with Representative Nordtvedt about the increase in mill levies when looking at in relationship to the CPI in terms of inflation. He stressed the increase in mill levies in Missoula and a 42 per cent increase in inflation. He stated that the 1981 Legislature and the courts and the administration did make changes in three categories; 34 per cent rollback, the loss of personal property tax in automobile license fees, and the loss of inventory tax. In Missoula, that represented just under a million dollar loss. This realized a shift of 20 per cent from one class of taxpayer back to the single family residential home.

REPRESENTATIVE HARPER noted that the reason this bill is written up with a local option is because of the great variation between county to county. The figures submitted don't separate residential from commercial from industrial and asked how that is relevant to this committee's deliberation.

REPRESENTATIVE NORDTVEDT stated when you single out residential, you will find the decrease in the property tax to be even more dramatic. The personal property and net proceeds on resources have been the explosive property tax sources of the last decade in the appraisal.

REPRESENTATIVE HARPER asked if the taxes on residences had raised a sort of disproportional amount, then wouldn't the findings here show us that the taxation of industrial property in the state is too low?

REPRESENTATIVE NORDTVEDT stated that for city and county purposes probably all property should be taxed on similar rates because they are being provided the same services. He said he would welcome the study of isolating residential property because they have had a substantial and constant reduction in their real property tax load over the last decade.

REPRESENTATIVE HARPER stated that not only do we have to treat the counties as individuals, but we have to treat individuals as individuals. People on fixed incomes in one of the bigger cities in the state, when their property taxes are raised, those people haven't realized any relief, and we have to give them some help.

REPRESENTATIVE NORDTVEDT stated that not only are the schools the main problem, they are the fastest growing component of property taxes, and he considers this problem to be the highest priority of the next legislature.

SENATOR DOROTHY ECK commented that it is still the residential property owners who pay the greatest portion of local taxes. She believes that industries that move into a community are not looking at the tax base; they are interested in the services provided by the community. She further submitted that this is something that needs to be studied and the burden falling on residential homeowners is important. Furthermore, she did acknowledge the fact that we have done some things to make the property tax a little less regressive in providing credits at the state level for property tax and also allowed the low income, elderly property owners a different classification at the county level. However, this again puts more of a burden on the average residential property owner.

Mr. Leon Stalcup mentioned another item in the way property taxes are done, and the fact that it creates a disincentive for new growth and new industry because it pushes reassessment value. The new homes, industries, buildings are taxed on a basis which includes those kinds of inflation factors.

REPRESENTATIVE NORDTVEDT stated that if this was happening in Mr. Stalcup's area, they are using the wrong manual. He referred to Mr. Harper's statement, not as a criticism but as a statistic, about the people on fixed income, and assuming that Representative Harper was

talking about people on Social Security and related kind of pensions, he stated that over the last decade these people on Social Security have seen more personal income growth than the rest of the population. Social Security was hedged for inflation, and their income situation has improved versus the rest of the population in the last ten years. Secondly, as a class, retired people have the same income distribution, so if there is a problem about "poor" senior citizens, it is the same problem for "poor" young people and middle aged people. He also referred to the three effects on the tax base that were mentioned, the one million dollars on vehicles and the 34 per cent on inventory taxes; the vehicles haven't diminished the tax base of local government because of the replacement revenues and the fees instituted. These have had no effect yet. There will be no effect because of the business inventory until 1983. Depending on what is done with local gas taxes plus block grants, it is yet to be determined whether we will replace this inventory tax base or not. In the 34 per cent case, the argument of the people with commercial property was that they were erroneously appraised; apparently the issue was sufficiently ambiguous that the Department of Revenue settled and didn't pursue the case. He further stated that he hopes this issue will be studied in the next few years and schools were taken off the property tax and that local governments would have an abundant tax base.

CHAIRMAN VINCENT thanked Representative Nordtvedt for presenting his statistics on House Bill 913, and concurred that the Legislature should take a serious look at residential property taxes. The discussion on House Bill 913 was closed.

HOUSE BILL 915

CHAIRMAN VINCENT called on Speaker Daniel Kemmis, sponsor of House Bill 915, to open discussion on this bill.

SPEAKER KEMMIS stated that what we are here to address is really the quality of life in Montana, and he encouraged the committee to think a little bit more about the future than we usually do and to think about possible alternative futures for Montana. The fact is that Montana is an extremely attractive place and for some reason it attracts and keeps good people. When we talk about either economic development or taxation policy, or the combination of the two, those are the things we should be thinking about. What can we do to advance civilization in Montana? There are two general approaches to the relationship between taxation policies and economic development: (1) supply side economics, which is to tax as little as possible, and to tax as little as possible those incomes that are most likely to be devoted to savings, and that is the upper incomes. This will encourage investment, which in turn encourages economic development. We have applied supply side economics in the last few years. Speaker Kemmis thinks this is a mistake and can see there are some serious questions about this method for economic development. When we get to the point of reducing the oil severance tax, of increasing investment tax credits, of reducing taxes on income from coal, as we have

done at the beginning of 1985, then we're creating a dangerous situation. He does not think anyone can think about economic development and not acknowledge that the key component is the training of a workforce. Education is the key ingredient of economic development. The Senate Education Committee has passed a four and four increase in the Foundation Program, which is a pretty modest increase. It forces more burden on the property tax rather than trying to shift education off the property tax, as Representative Nordtvedt has suggested. However, we can't afford it. We don't have enough ongoing revenue and we will spend \$50 million of one-time revenue to fund this four and four per cent increase in education. What we're doing here is putting off a very difficult decision. We do need to raise more money for education in Montana and this is mainly the thrust of House Bill 915. We also can't do what is needed for local governments to stimulate new businesses. Next session, if we're going to do anything about education, we're going to have to come up with \$50 million right off the bat in order to keep even, \$50 million that just isn't there. This is a disastrous situation to face. There is no continuity, nor predictability where we're going to come up with that \$50 million next session to keep education even, let alone to invest in it in the way you should. When you talk about attracting business to Montana, then you can't ignore how people feel about property taxes. If we've gotten to the point in this session where we're going to balance the budget with a series of bookkeeping maneuvers and using one-time money, he thinks this is a mistake and on an erratic path that is not consistent with good economic development. We must take care of the situation as it exists right now and that's the reason this bill was introduced.

CHAIRMAN VINCENT asked for comments.

Mr. Richard Barrett, Associate Professor of Economics at the University of Montana submitted written testimony.

SENATOR DOROTHY ECK states that she and Senator Blaylock have been discussing income tax and looked at a number of ideas that could generate additional taxes. One we might look at sometime is the possibility of limiting the amount that's being deducted that is federal income taxes. She added that she asked the Department of Revenue to run that out, what it would be if we put a limitation of \$10,000 for a joint return and \$5,000 for separate returns, and they indicated that this would return \$25 million a year. There are now a couple of states who do put a cap on the amount of federal tax that can be deducted. One advantage of this is it does not show up as being a very high percentage at the top end, but it has the same effect as raising the tax for higher income tax payers.

SENATOR CHET BLAYLOCK spoke as a proponent for the bill, stating that we are all concerned about the civilization and the quality of life in Montana. Because Montana has a sparse population, we can't live here as cheaply as elsewhere, and we have to address this problem. Maybe we foolishly in the past said that we wanted six units of the University System, and that we wanted five Vo-Tech schools, and that we wanted three community colleges, which we have expanded this session.

If we want these things, they are going to cost us and the fair way to do this is through our income tax structure. I have never had any indication from my constituents that they want less government in this state, and he commended Representative Kemmis for bringing this bill in and said he thought it should be studied.

REPRESENTATIVE NORDTVEDT presented the committee with a handout and discussed it. A hypothetical middle-income Montanan with an income of \$32,000 per year would be in the 22 per cent federal tax bracket. Under the Kemmis bill, he would be in the 11 per cent state tax bracket. His total tax rate would be almost 38 per cent, and he takes home 62 cents for earning another dollar, so his incentive has been significantly reduced. For the middle-income American, he is not getting a real return on his savings after inflation and taxes, with the four per cent inflation rate we now have. He further stated that the main detrimental effect of increasing income taxes is that it would put Montana in the dubious position of having the highest marginal income tax rates of any state in the nation. He believes collecting more income taxes would increase the growth of state government. He feels that the diversion of people into the political life rather than productive life may not necessarily enhance civilization. If there is a preception that increasing public sector budgets will solve the basic problems, then you are going to have taxpayer resistance. Therefore, the main objection to increasing income taxes, he believes, would be to increasing the public sector at the expense of the private sector. This would not manufacture new dollars. He further stated that many people are reducing their productive effort as a result of that. He feels that the result of excessive tax rates on productive effort is that the total quality of the productive effort of everybody shrinks.

Mr. Leon Stalcup of Missoula stated that one of the aspects of economic development is that you have to have people in the workforce and start new businesses. Fifty-five of the people who live in Montana live in cities and towns, and pay for all the services. Thirty per cent of all the property tax is in those cities. A rather small shift in an income tax can cause large shifts in income to the state. Montana's participation in local government winds up in being fourth from the bottom, which makes Montana a very rich state in its ability to raise revenue. Local governments are not. Local government is stuck with just the property tax. He feels that local governments would support some small increases in income taxes rather than continue the large increase in property taxes.


REPRESENTATIVE GLENN SAUNDERS, District No. 52, stated that we have so many complex tax laws that we have to hire an expert to take care of our taxes


Mary Vant Hull, Bozeman City Commissioner, stated that she didn't feel people would mind paying more taxes because they can see it will save them a lot of money. If the Legislature raises enough revenue so that they can properly maintain their streets; it means that people won't have to rush out and buy new cars so soon; it means that we can buy books for our library; it means that they won't have to go out and spend money on their own books. She stated

that if taxes aren't raised enough, it would be a very false economy when people had to hire their own guards and fire protection. If gas taxes were raised, you would be saving the people of the state money and she hoped that they would be farsighted instead of cutting here and letting other things rise.

In closing, SPEAKER KEMMIS stated that he wanted to respond to Representative Nordtvedt's comments pertaining to marginal tax raises. When we talk about economic development in Montana, one of the things we have to be serious about is the investment research in Montana in the public area and whether we can do that without additional revenue. The one example that really stands out in this session, apart from research, is investment in computer technology and computer training for our young people. All the units of the University System put in modification requests for new computer equipment to give access to students to computers. All those modification requests had to be stripped from the budget. I think it's time that we ask ourselves whether that is a good economic development policy. I think we're failing to train a workforce; we're failing to invest in the cutting edge of our society. We simply can't do it unless we have more revenue.

CHAIRMAN VINCENT closed the meeting on House Bill 915, thanked the members of the committee and witnesses for their participation on what he felt was a productive meeting and adjourned the meeting at 12:10 p.m.


JOHN VINCENT, CHAIRMAN


Joyce Andrus, Secretary