MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE
HOUSE OF REPRESENTATIVES

April 20, 1985

The fifty-seventh meeting of the Taxation Committee was called to order in room 312-1 of the state capitol at 3:12 p.m. by Chairman Gerry Devlin.

ROLL CALL: All members were present with the exception of Representative Asay. Also present were Dave Bohyer, Researcher for the Legislative Council, and Alice Omang, Secretary.

CONSIDERATION OF SENATE BILL NO. 455:

QUESTIONS ON SENATE BILL NO. 455: Chairman Devlin said this meeting is to ask questions on SB 455. Exhibit 1 is information on this bill presented by the Department of Revenue.

Representative Raney asked what this bill does. Mr. LaFaver said, as close as they can estimate, there is no net fiscal impact - there may be a slight loss but it is as close to a wash as they can determine. Mr. LaFaver said basically this bill would tax dividends that corporations receive, called portfolio dividends; an example of a portfolio dividend is: Montana Power owns a few hundred shares of General Motors; they get dividends from those shares; and under SB 455, the Department of Revenue would tax those dividends; Attachment B of Exhibit 1 shows that $231,666 would be generated from that tax. Offsetting that amount is the allowance of corporations in Montana to file a consolidated return and that allows a joint venture in Montana to offset winners and losers and lower their tax liability. He indicated that that gives Montana firms the same advantage as multinational and multistate firms; and with the bill as amended, that is the only effect on the corporate tax. Mr. LaFaver said the rest of the bill deals with how counties get a share of that income - now they receive the bank tax and this would give all the counties approximately 8% of the entire corporation tax rather than just the bank tax. He contended that from the counties' standpoint, that has some advantages; it eliminates the extreme volatility of depending on the bank tax and ties them to a more stable revenue source.

Chairman Develin asked if Attachment E deals with the distribution of the bank tax only. Mr. LaFaver replied that the first column deals with the average of two years from the bank tax and the columns marked "FY86 PROPOSED" and "FY87 PROPOSED" are the percentage the counties would receive from the corporation license tax. The increase is due to the help of the corporate license tax as a whole as opposed to the bank tax, he advised.

Mr. LaFaver said Attachment E shows the amount of money each county would receive without taxing 85% of section 243, 244, and 245.

Chairman Devlin asked if there is any way the department can forecast beyond FY 1987. Mr. LaFaver responded that he could put a number on it but he does not feel that is acceptable. He said, the farther you go with projecting revenue, the wider your margin of error.

Representative Sands noted that corporations generally don't like to file combined returns - part of the bill would allow Montana corporations to file combined returns. He asked what kind of company would pay more tax by filing a combined return than it would by taking the exemptions under current law. Mr. LaFaver said, as an example, a company that, for its overall combined operation, there was little income from Montana.

Representative Sands inquired if these are corporations that have high income in this state. Mr. LaFaver responded that it would be a corporation where a small amount of their profit was made in Montana. He referred to Attachment H of Exhibit 1, noting that they have criteria for determining whether a combined return can be filed. He said, however, there is an area of negotiation here; it is not all black and white.

Jerry Foster from the Department of Revenue referred to Attachment G which distinguishes between consolidation and combination and points out some of the similarities. He said the purpose of the combination return is, when a corporation operates across state or national borders, they can shift income. Under consolidation, they have to have jurisdiction over all of the members to consolidate, he explained, and Montana is unique in that we have unitary language in our consolidated statute.

Chairman Devlin questioned if the Department of Revenue determines whether a corporation can file a consolidated return. Mr. Foster answered that this is a discretionary statute and they have tried in the past to change or repeal those statutes to no avail - this bill takes the discretion away from the department and allows everyone to consolidate. He said the only criteria is 80% ownership and they would follow federal rules.

Representative Gilbert noted that, on Exhibit B, the department only used the top 45 corporations and he asked how many more corporations are out there. Mr. LaFaver responded that these are 98-99% of everything affected by this bill.

Representative Gilbert asked if that means all of the other corporations in the state would only contribute 1-2% from this bill and Mr. LaFaver said that is correct.

Representative Gilbert inquired what the refunds on Attachment D of Exhibit 1 represent. Mr. LaFaver explained that those are refunds from lost litigation on U.S. obligations and net operating loss carrybacks. When a bank asks for a refund, the department gives back 20% and the counties have to refund the remainder, he advised; this attachment shows money that the counties cannot anticipate needing; they have no way of knowing how well a bank will do or if a bank has litigation; and this is not meant to say the counties aren't making money.

Representative Gilbert asked why the corporate license tax is increasing - is it because the department is more accurately pursuing loopholes or because businesses are actually doing that much better. Mr. LaFaver replied that he hoped it is due to both; corporation license taxes are a much more dynamic revenue source than the bank tax because the bank tax goes up and down and this one stays flat.

Representative Gilbert asked what percentage the corporate license fee increases. Mr. LaFaver answered that his gut feeling is 4-5% per year but he deferred to Representative Harp who has worked with the revenue estimates for years. Representative Harp said we could get those figures.

Representative Gilbert indicated that he just wants to be sure there is stability there because he sees corporations going broke every day. Mr. LaFaver said the increase is a cause of what is reflected in the economy as a whole and there is an inflation component here.

Representative Switzer asked if the refunds were based on an individual income tax basis. Mr. LaFaver responded that it is similar to the direct relationship that a property taxpayer has.

Representative Switzer noted that Mr. LaFaver indicated that there would be no net impact. He said someone has to be impacted if there is an offset; and he asked who that someone is. Mr. LaFaver replied that no one pays any more taxes than they otherwise would with the Brown amendment; the reason the counties get more is because they are getting money that the state otherwise would have received; and prior to this bill, the state would have gotten the entire increase.

Representative Switzer asked how the department determines how much each county will receive. Mr. LaFaver said the 8% or whatever is taken from the corporate license tax; and that money is distributed to the counties by population, except no county would get less than they got under the average.

Representative Switzer said he was uneasy basing this on a population basis.

Representative Williams inquired if, assuming we remove the Brown amendment and go back to the original bill, the corporations that do not come under the provision for Montana corporations, prior to the transfer of dividends, do they pay tax on their total income including the dividends transferred to the mother company or are the dividends transferred before they pay. Mr. LaFaver answered that that depends on whether we combine them or not. If they are not combined, the department looks at each of them separately and the proportion of income they had in Montana gets allocated to Montana, he explained. If we do combine them, that entire income gets thrown into the larger pot and we get our share of that larger pot, he further advised.

Representative Williams asked, if they are filing a combined return, there would be no double taxation? Mr. LaFaver responded that they cannot tax dividends of a firm that is filing a combined return and this is only an issue for a firm that does not file a combined return.

Representative Williams asked, if a corporation does not file a combined return, can they take that income for the business in the state of Montana and pay the corporate license tax on the total income for that business; then can they transfer the dividends to the holding company outside of Montana; are those dividends that are transferred outside of Montana, under the proposed SB 455 without the Brown amendment, taxable? Mr. LaFaver replied that they could be only if we have jurisdiction over that company and, in a lot of cases, we don't have jurisdiction under that company; the parent company would have to be doing business in Montana; and they are taxed on their income but dividends are tax deductible.

Representative Williams questioned if there is double taxation to any degree on those companies that cannot comply to the combined report under SB 455 without the Brown amendment. Mr. LaFaver responded that they did not think so; the major point here is, without the Brown amendment, or the bill with the Brown amendment, you not only allow one loophole, you allow two because a firm can go out and borrow money to buy a subsidiary and deduct that interest expense and when the money comes back, they can't tax it. He said by allowing the consolidated return and allowing us to tax dividends on those firms that are not combined, we are treating everyone alike and we are taxing that income once.

Representative Sands noted, in the letter to Bob Gilbert, Attachment C of Exhibit 1, he, (Mr. LaFaver) said that, under consolidated return, a portion might be taxed more than once. Representative Sands noted that that isn't exactly the situation you have with multistate corporations who can't file a combined return, and he asked if they aren't taxed twice just as intrastate companies that couldn't file consolidated returns could be taxed twice if the consolidated return provision wasn't available. Mr. LaFaver explained if all the state tax statutes were like Montana, the answer might be yes. He said they are not; and there are states in our immediate vicinity that have no corporate tax so, to the extent that an entity that's solely in Montana can be either combined with a firm that's predominently in a tax-free state or that were precluded from taxing the dividends, then, for Montana, that income is not taxed.

Representative Sands indicated that in order to prohibit the possibility of shifting income from Montana to a state where there is less tax, we are going to deal with that potential problem by making sure that we tax them twice in this state. Mr. LaFaver said he did not think we are taxing them twice in this state. Mr. Foster advised that we usually don't have jurisdiction over those companies, chances are we can't touch that dividend because they didn't meet the criteria to file a combined return; and that dividend probably doesn't meet the definition of business income so there is little chance, if any, that there would be double taxation.

Jeff Miller said we rarely have jurisdiction to tax the parent company out of state that is receiving the dividends; our concern is taxing the entity here that is doing business in the state of Montana; and we do that based on their earnings. If they select the pay difference in their parent corporation, that dividend is only includable to the extent that it (1) constitutes business income and (2) that we have the jurisdiction to tax that parent corporation, he concluded.

Representative Sands pointed out that if there is no jurisdiction to tax the parent corporation, then this whole question on whether or not the section 243 provision applies is irrelevant. Mr. Miller said that's correct.

Representative Sands replied that that is not correct; we have many parent corporations that are filing here and receiving tremendous amounts of dividend income from subsidiaries that don't operate here; that income is integral income to that parent corporation; and it is a return on investment and a recovery on all kinds of administrative costs. It's part of their business income and it should be held back. It's taxable to the extent that the parent gets its fraction, whatever that portion is, he declared, and for the Fortune 500 corporations, that portion is much less than 1 percent.

Representative Sands indicated that they are talking about the parent corporation in Montana and the subsidiary in a state which has a corporate license tax greater to or equal to Montana's, in that situation, with no consolidated returns, they may have double taxation. Mr. Miller said Montana does not have double taxation.

Representative Sands stated he is talking about the taxpayer. Mr. Miller replied this would depend on how the other states treat the situation.

Representative Sands added that what he is saying is that there would be double taxation if that other state just taxed the subsidiary. Mr. Miller responded that if that subsidiary paid dividends to the parent corporation, yes that would be taxed to the parent. Representative Sands contended that that taxpayer would pay taxes twice on the same income. Mr. Miller replied that he did not know if it would be considered the same income, but yes, there would be, but he could not comprehend this kind of situation. Representative Sands emphasized that these are the taxpayers who will be affected by this bill.

Mr. Miller asked if Representative Sands was talking about a domestic corporation with holdings outside the state, or about a parent corporation, part of whose activities are in Montana. Mr. Miller explained that the situation most commonly encountered, and those that are addressed by this bill, is one in which there is a major multinational company that has just a small fraction of activity within the state, and they happen to be the parent corporation; they do not qualify and they receive a substantial amount of dividend income. He advised that under present law that income is gone; and under this bill, with or without the amendment, most or part of that income remains.

Mr. Miller indicated that if every state imposed taxes just like Montana, there would be double taxation. The fact is, he said, his experience in dealing with multinational companies indicates that their level of accountability, regarding state income taxation, taking into consideration all the states that do tax, and all of the various factors, you will have much less. He commented that the situation described is a scenario and kind of difficult to follow; and it does not exist because all states don't tax on a corporate income basis. Further, because of different accounting devices, the level of taxability for state income tax purposes is much less than 100 percent, he advised.

Representative Sands said his concern is this: When there is a consolidated intrastate company, Mr. Miller says "We don't want to tax them twice." - this is an obvious concern, which Mr. Miller has. Representative Sands stated that it seems to him if that company, the subsidiary, is not in the same state, but just happens to be across the line, that if fair treatment of the taxpayer is a concern, Mr. Miller should be just as concerned about the double taxation when the dividend is across the state line as he would be if the dividend was transferred within the state.

Mr. Miller said the situation of consolidation versus combination and the situation of wholly domestic, which is only the consolidation situation, versus the multistate, are very different situations in terms of the level of accountability for state income tax. He advised that wholly domestic corporations have no opportunity and no ability to say that income was earned in South Dakota and this income was earned in Washington, etc. He indicated that they see 100% of what they report to the federal government, and they pay tax on that. If they're going to consolidate, he advised, there is a different situation than if there is a multistate situation which is operating at maybe less than 1 percent of their activity. He said he doesn't believe the double-taxation situation exists for the multistate corporations.

Chairman Devlin referred to the letter from Mr. LaFaver and said he was disturbed by several remarks. He referred to page 6 which says "the net effect is to insure in nearly all cases that dividend income is taxed only once by Montana for corporations of all types." He said the word "nearly" shows up throughout the letter. He referred to page 7...."It insures that in virtually all cases, Montana will tax dividends to corporations only once." He indicated that he wants to know why "virtually" and "nearly" enter into this; those same words appear in the letter sent to Representative Gilbert, and he referred to page 2 of that letter. He declared that this "nearly" bothers him a lot because when those words are used it usually means it's not quite certain that they won't be taxed more than once.

Mr. LaFaver indicated that a couple of points come to mind - first, when you are dealing with thousands of taxpayers, it's not possible to make a statement saying that this affects every one of them in this way; every one of these corporations is a unique entity; they are trying to be as honest as possible as to how they see this thing working; if there were an exception of any magnitude, they would say so; but of all those thousands of taxpayers, there may be some abberation that nobody thought about which is worth a few dollars. He said they could have overstated the knowledge that they have; they have done a lot of work with the corporations that will be paying virtually all of this tax, and they have given an honest evaluation of how this tax will impact the organizations that are affected.

Chairman Devlin contended that then the department of revenue is not entirely sure within themselves that maybe somebody won't be taxed more than once. Mr. LaFaver responded that due to the homework they have done on this bill, they know more about the impact of the bill than any other bill that was passed. He said a lot of homework has been done, and more than any tax bill he has been involved with this session, this bill has been researched.

Representative Cohen said regarding the Brown amendment, looking at Attachment B and comparing the two columns, there seems to be some significant differences. He specifically referred to number 46 of the amendment. He asked if these are cases where there is an out-of-state parent corporation that does not choose to file a combined return; and he asked why they would choose not to file a combined return.

Mr. LaFaver replied that they should look at the bottom line; and if consolidation means they pay less tax, they will combine. Representative Cohen noted on the other hand, if the other states where they oeprate are states where they pay no tax at all, and even with the increased tax payment we would have had here, they might still choose not to combine in order to avoid putting any of their income at risk taxation. Mr. LaFaver responded that they are looking at a number of factors in the various states, and they are interested in the situations in those other states. He said it's fair to say that their bottom line is if they think they are going to pay less taxes over a period of time by going with the combined, that's what they're going to do. If it's less to file separately, then they will argue that they should file separately, he advised.

Representative Cohen inquired if the combined return is a federal instrument. Mr. LaFaver answered that it's in-state law and is an accepted way to tax multinational/multistate corporations.

Representative Cohen said there are factors which determine whether a corporation is unitary, and if it's to a taxpayer's disadvantage to be unitary, he will probably interpret those factors to indicate that he is not unitary.

Representative Patterson questioned if these 48 companies are all the companies that will be affected by the bill, or are there still more? Mr. LaFaver responded that he thinks what he said is that in their best judgment, they are catching 98-99% of the income that would be generated under either version.

Chairman Devlin questioned, looking at the senate bill without the Brown amendment, if a company had to pay $1.5 million for taxation, will that company stay in this state? Mr. LaFaver replied that he is quite certain that they will .

Chairman Devlin asked what would happen if they sold their product under a different name. Mr. LaFaver said a name change isn't going to change the fact of whether or not they're unitary - changing their name won't change the base equation.

Representative Patterson referred to an amendment sponsored by Representative Keenan and asked if after two years, some counties that are getting money now will not get any in the future. Mr. LaFaver answered that as he understands that amendment, after two years, the formula will be used, so that every county as long as someone lives there will get something, but the "save harmless" would expire after two years.

In response to a further question from Representative Patterson, Mr. LaFaver responded that the hard comparison is "lose money compared to what they would have had." He said if the bank tax is left as is, many of the counties that show a healthy bank tax collection in 1983 and 1984 aren't going to see that in 1985 and 1986; the threshhold they are looking at is the average of '83 and '84; and under Representative Keenan's amendment, no one would get less than that. After two years someone could get less; after two years the safety net is off (under the Keenan amendment), he explained.

Representative Gilbert referred to the letter sent to him by Mr. LaFaver. In the third paragraph there is the following statement: "The proposal to tax 'Section 243, 244, and 245' dividends was made to close an inequitable tax loophole, he noted. The exemption of these dividends was never specifically enacted by the Montana Legislature." He indicated that he has information which says that although it was never specifically enacted, it was very specifically repealed in the 1973 session (chapter no. 372), and there was direct reference made to that in the Baker Bank Corporation case. Mr. LaFaver responded that it's his understanding that there was a cleanup piece of legislation, not a substantive change in the law. That's the history they've come up with from their files, he said.

Representative Gilbert noted that he has a copy of the 1973 act before its repeal, and it says the term "net income" means the gross income for a corporation less the allowable deductions, however, the deductions for gross income and net income as set forth in this section shall not be construed as allowing the deduction set forth in section 243 of the internal revenue code. He declared that this couldn't be more clear; those deductions clearly do not apply, and this law was repealed in 1973. The law that was enacted says basically that the deduction that is available under the federal tax code should be adopted, he said, and this seems clear to him, and apparently it was clear to the court in the Baker Bank case too, because it concluded that this allows the 243 deduction. He reiterated that he doesn't see how it could be anymore clear.

Chairman Devlin asked Jerry Foster to comment on the bill that was enacted (when the other bill was repealed in 1973). Mr. F oster said the intent of the bill is to ch ange the definition of gross and net income. In doing that change, it was felt that it was repetitive to allow section 243, so the language was taken out -- because they thought that it was unnecessary -- and that by the definition of net income it was explicit that section 243 wasn't allowable, he advised. Baker Bank picked up on this, and they cited a couple of other cases, and they determined that when the definition of net income was changed, not only were all of our deductions adopted, but all of the deductions under IR code too, unless specifically provided for otherwise; he explained. This was the department's bill, he declared; they deleted it; maybe they made a mistake, and they do not agree with Baker Bank now; and, in fact, never did, he advised, saying that it was not the legislature that introduced the bill to repeal 243, it was the department.

Representative Sands indicated that the bill said, before that, the 243 deductions were not allowed; then that was repealed; and what was provided instead, was a law that says the same deductions that are in the federal code are to be used, unless otherwise specified. Mr. Foster replied that that was what Baker said and they (the department) said that they only allow those deductions in 84-1502, which is their deduction section. Mr. Foster commented that the department does not agree with this interpretation. Representative Sands declared that it what the Supreme Court says is law. Mr. Foster said this is correct.

Mr. LaFaver explained the supreme court rules that the deductions allowed under federal law are to be used unless they are specifically exempted under state law. He said what they are proposing is consistent with that ruling. Representative Sands said the supreme court said the 243 deduction did not apply, and this bill says that 243 is not allowed, and those two things are basically inconsistent. Mr. LaFaver replied that he does not agree with this at all; the supreme court said 243 is an allowable deduction because it's included in federal law and it hasn't been specifically exempted in state law. They are proposing to include it in state law, so if it should go back to the supreme court, they will say that it is no longer a deduction, he informed the committee.

Representative Sands asked, supposing the law is just the way it is today, and there is a corporation which has not filed a combined return, if all the income generated in Montana by that company is taxed in Montana? Mr. LaFaver said yes.

Representative Sands noted that on Attachment A, 35 corporations are shown and a total tax effect of $302,130; Attachment B shows 48 corporations and with the Brown amendment total taxes are $231,666; and he asked for an explanation of the difference between what is shown on the two attachments. Mr. LaFaver said

Attachment A shows 1983 returns for 1982 income; and Attachment B shows 1984 returns for 1983 income.

Representative Sands asked if he is saying that in 1984, the state had 13 more corporations affected by this so that the total tax effect was $70,000 less. Mr. LaFaver explained that there are a lot of corporations listed that paid little or no tax; Attachment A only shows those corporations that had a tax effect; and on Attachment B there are a number of corporations that had no tax effect.

Chairman Devlin asked Mr. Cadby, who represents the Bankers' Association, if this was true. Mr. Cadby said the association was originally interested in SB 203, which is still in the Senate Taxation Committee, to provide a distribution formula for local government, and that bill was tabled in committee. Then they met with the department of revenue and agreed to putting SB 203 into this bill, so the one part of this bill that incorporates pre-distribution of income is the same as SB 203. He indicated that the reason the association supports the other part of this bill is that it provides consolidated returns; the Bank of Montana system, which had 15 banks, was allowed to file consolidated returns by the department of revenue until a couple of years ago; and other bank systems were not able to file consolidated returns. He said he thinks that is probably what motivated that system to challenge the taxation of their banks and brought about the Baker Bank case.

Chairman Devlin said the bill that addresses the concerns of the Banking Association is now in a senate committee. Mr. Cadby informed the committee that the bill addresses the concerns of local government, not just banking concerns. He said the basic bottom-line problem now is that the committee is being asked to make a judgmental decision; it is his association's judgment that it would be safer to have local governments share in all corporation income tax revenues, as compared to targeting one taxpayer within a county and taking a share of his revenue for local government. He said there's no denying the bankers like consolidated returns; they reduce taxes.

Chairman Devlin said two years ago the committee looked at a similar bill with the exception of addressing the consolidated returns to the banks, and he asked Mr. Foster if this is correct, who responded that that was correct.

Chairman Devlin said if the banks' part of this was taken out, the two bills would be almost identical. Mr. Foster said that's right. Chairman Devlin asked what happened to that earlier bill and Mr. Foster answered that it passed the House.

Mr. LaFaver advised that two years ago HB 550 was the first part of this bill in that it taxed inter-corporate dividends and the department of revenue argued that this was double taxation.

Representative Sands inquired of Mr. LaFaver if DOR opposed HB 550 because it would eliminate the 243 deduction and result in double taxation. Mr. LaFaver said this is correct.

Representative Sands contended that this bill (HB 455) solves that problem by allowing those companies to file consolidated returns. Representative Sands contended that now there are some corporations that cannot file combined returns, because they do not meet the unitarian rule and now, they are going to be taxed twice, just like they would have been taxed twice under HB 550. He asked why this is fair -- anymore than HB 550 was fair two years ago? Mr. Cadby responded that he thought the argument of the DOR is that if you are an out-of-state corporation you can move your income; and if HB 550 had passed, they were going to move all the holding companies into Wyoming.

Representative Sands indicated that this is just what the corporations will do. Mr. Cadby replied that he doesn't know what they will do; he can speak for the banks only; and the unitary idea is interesting. He advised that there was a court case a few years ago, where a paper company located in the south had a ranch in Montana, and they were filing separately - this wound up in court, and the court said they were a unit, he said. (End tape 57-1-B)

<u>Tape 57-2-B</u>

Representative Switzer asked what happened to 203 in the Senate. Mr. Cadby replied that there were a lot of flaws in the bill and originally it was opposed by both the DOR and local governments. The flaws were corrected; they had 10% of 203 which would have taken more money out of the general fund than that which they were projected to pay into the general fund, he responded.

Representative Switzer questioned what were the things put into SB 455 that are okay and not okay in the other one. Mr. Cadby replied that he has three pages of amendments to 203, and the bill with those amendments does solve the distribution problem. Those amendments basically duplicate this bill with respect to distribution only; it has nothing to do with taxing dividends or providing consolidated returns.

Representative Switzer asked if the bill pools all the bank income in the state and redistributes it on a population basis. Mr. LaFaver said, "Yes, SB 203 does exactly what SB 455 does with respect to distribution." SB 203 allows the money to stay in the general fund, and 8.86% of whatever is in the total fund goes back to local governments on a per capita basis, he explained. The whole idea was to change the method of distribution, he said, and the most equitable method of distribution seems to be based on population.

Mr. Cadby contended that if banks and savings and loan organizations are to be treated the same as their competition, and the same as all other corporations doing business in the state, all of the income tax revenue paid by these institutions should be put in the general fund; and none of it should be distributed back to the counties because none of the other corporations are distributing any of their income back to local government. The banking community thought this was not possible to achieve because of counties' reliance on this money, he pointed out, and if you take a piece of what all corporations pay and give it back to local government, in a way you are saying we are making up for the loss of the merchants inventory tax, and perhaps other personal property taxes that have been repealed over the last 10 years.

Chairman Devlin said he thinks Mr. Cadby's statement is fairly accurate.

Chairman Devlin asked Mr. Cadby what are the consequences if his group gets nothing passed this session? Mr. Cadby answered that presently there is no real incentive to move out of state; the banks would continue to pay the same income tax on their net earnings as they do now and 80% of that amount will go back to the counties and cities, which the bankers feel is an inequitable means of distributing that money. Mr. Cadby informed the committee that the only way a county could get hurt as far as getting a percentage of the total pot would be if the total fund went down.

Chairman Devlin said if the bill is amended, only the banks would be affected.

EXECUTIVE ACTION SB 455: Representative Cohen made a motion that the bill BE CONCURRED IN and that the Brown amendment be removed. Chairman Devlin called for a roll call vote. The motion FAILED due to a tie vote of 10-10.

Representative Iverson made a motion that SB 455 be TABLED. Chairman Devlin called for a roll call vote. The motion PASSED 12 - 8.

ADJOURN: There being no further business, the meeting adjourned at 4:53 p.m.

Gerry Devlin

GERRY DEVLIN, Chairman

Alice Omang

Alice Omang, Secretary

DAILY ROLL CALL

HOUSE TAXATION COMMITTEE

49th LEGISLATIVE SESSION -- 1985

Date April 20, 1985

NAME	PRESENT	ABSENT	EXCUSED
DEVLIN, GERRY, Chrm.	X		
WILLIAMS, MEL, V. Chrm.	X		
ABRAMS, HUGH	X		
ASAY, TOM		X	
COHEN, BEN	X		
ELLISON, ORVAL	X		
GILBERT, BOB	X		
HANSON, MARIAN	X		
HARRINGTON, DAN	X		
HARP, JOHN	X		
IVERSON, DENNIS	X		
KEENAN, NANCY	X		
KOEHNKE, FRANCIS	X		
PATTERSON, JOHN	X		
RANEY, BOB	X		
REAM, BOB	X		
SANDS, JACK	X		
SCHYE, TED	X		
SWITZER, DEAN	X		
ZABROCKI, CARL	X		

CS-30

ROLL CALL VOTE

HOUSE COMMITTEE TAXATION

DATE April 20, 1985 BILL NO. SB 455 TIME

NAME	AYE	NAY
DEVLIN, GERRY, Chrm.	X	
WILLIAMS, MEL, V.Chrm.	X	
ABRAMS, HUGH	X	
ASAY, TOM	X	
COHEN, BEN		X
ELLISON, ORVAL	X	
GILBERT, BOB	X	
HANSON, MARIAN	X	
HARRINGTON, DAN		X
HARP, JOHN	X	
IVERSON, DENNIS	X	
KEENAN, NANCY		X
KOEHNKE, FRANCIS		X
PATTERSON, JOHN	X	
RANEY, BOB	M	X
REAM, BOB		X
SANDS, JACK	X	
SCHYE, TED		X
SWITZER, DEAN	X	
ZABROCKI, CARL		X
	12	8

Alice Omang

Secretary Alice Omang

Chairman Gerry Devlin

Motion: TO TABLE.

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ROLL CALL VOTE

HOUSE COMMITTEE TAXATION

DATE April 20, 1985 BILL NO. SB 455 TIME

NAME	AYE	NAY
DEVLIN, GERRY, Chrm.		X
WILLIAMS, MEL, V.Chrm.	X	
ABRAMS, HUGH	X	
ASAY, TOM		X
COHEN, BEN	X	
ELLISON, ORVAL		X
GILBERT, BOB		X
HANSON, MARIAN		X
HARRINGTON, DAN	X	
HARP, JOHN		X
IVERSON, DENNIS		X
KEENAN, NANCY	X	
KOEHNKE, FRANCIS	X	
PATTERSON, JOHN		X
RANEY, BOB	X	
REAM, BOB	X	
SANDS, JACK		X
SCHYE, TED	X	
SWITZER, DEAN		X
ZABROCKI, CARL	X	
	10	10

Alice Omang
Secretary Alice Omang

Chairman Gerry Devlin

Motion: To remove the Brown amendment.

CS-31

Exhibit 1
SB 455
4/20/85
Dept. of Revenue

DEPARTMENT OF REVENUE

TED SCHWINDEN, GOVERNOR

STATE OF MONTANA

MITCHELL BUILDING

HELENA, MONTANA 59620

April 19, 1985

Rep. Gerry Devlin
House of Representatives
State Capitol
Helena, MT 59620

Dear Rep. Devlin:

This letter is a reply to your letter of April 18, 1985, concerning SB 455. I will answer your questions by categories as they arise in your letter.

Third Fiscal Note

We estimate that SB 455, as presently amended, has little or no impact on total revenues. There are two factors that go into this estimate: 1) the revenue raised from the taxation of portfolio dividends and 2) the revenue foregone by allowing consolidated returns.

The revenue gained from taxing portfolio dividends was calculated from records compiled from returns filed in 1983 for 1982 income. During 1983, corporation tax auditors kept manual records of dividends excluded from tax as a result of the Baker Bancorporation decision as they conducted office audits. From these records, we identified $302,130 in additional tax that would have been due from 35 corporations if portfolio dividends were taxed. A list of the amounts that the corporations would have had to pay is attached (Attachment A).

These records are the basis for the $300,000 estimate in the fiscal note of the revenue to be produced annually from portfolio dividends. Information collected from returns filed in 1984 to estimate the impact of Rep. Brown's amendment further confirms this estimate.

To estimate the revenue foregone because of consolidated returns requires information on interlocking ownership of Montana corporations. That information is generally known by the Department only for financial corporations and not for the non-financials, although both types of corporations will benefit from consolidated returns. Thus, we estimated this portion of the fiscal impact by examining the returns of financial corporations expected to receive the largest benefit, and making a judgment of the likely benefits for non-financial corporations. The 1983 returns of the four bank groups most likely to benefit were reviewed, and the tax effect of consolidated returns was estimated. One of the four corporate groups was estimated to receive no benefit from consolidated returns. The other three groups would have reduced their tax payments by $266,172 if consolidated returns were available. For non-financial corporations, our best judgment is that their tax reduction would equal the reduction enjoyed by financial corporations. This judgment was made by professional staff with over a decade of experience reviewing corporate returns. Thus, our estimate is that allowing consolidated returns will reduce revenues by $300,000 to $500,000 annually.

Impact of the Brown Amendment

Rep. Brown's amendment eliminates the major source of revenue produced by the bill as originally introduced: dividends received by corporations from subsidiaries in which more than an 80% ownership share is maintained.

The entire class of corporate taxpayers that will benefit from the Brown amendment are multistate or multinational taxpayers.

Based on the more extensive review of corporations, we estimate that the net revenue lost by state and local government as a result of the Brown amendment will be $2.5 million annually.

To document this estimate, I am attaching a list of corporations most likely to be affected by the amendment (Attachment B). That list is comprised of corporations in two categories:

1) The largest 45 corporate taxpayers filing returns in 1984 on 1983 income, and

2) 3 other corporations identified by professional auditors as receiving a significant amount of 80% subsidiary dividends.*

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*One corporation was excluded from the top 45 corporations because it has recently undergone a major corporate reorganization that will reduce its dividends by an unpredictable, but substantial amount.

Under SB 455 in its original form, these corporations would have paid $2.9 million more in tax in 1984.

With the Brown amendment (taxation of portfolio dividends only), these corporations would have paid only $231,000 more in tax in 1984.

Because the staff has worked to identify the most likely affected corporations beyond the largest 45, we believe that these estimates are reasonably complete.

Based on this information, the estimate of the net revenue that would be gained from SB 455 without the Brown amendment is $2.5 million annually. ($2.9 million revenue gain from taxing all dividends minus the $.5 million revenue loss from consolidated returns, and plus $.1 million revenue gain from smaller corporations not reflected in Attachment B.)

<u>Special Note on Decker Coal</u>

We understand that representatives of Decker Coal and its interlocking set of corporate owners are claiming that SB 455 will have a major effect on their tax payments. We believe their claims are greatly exaggerated. However, to provide accurate information on the effect of the bill on Decker and its owners would require us to release confidential information. We are prepared to do so if the means can be found to release this information. We are confident that you would then find that the claims of this corporate group are inaccurate.

<u>Taxation of 243 Dividends</u>

You are correct that the letter to Rep. Gilbert (Attachment C) states reasons for taxing corporate dividends as proposed in the original SB 455. In summary, the rationale is as follows:

1) Dividends are income and should be subject to tax for corporations as they are for individuals. To fail to do so is to grant multistate and multinational corporations a special tax loophole that is unfair to the thousands of Montanans who pay taxes on their dividends.

2) This corporate tax break is, in many cases, a <u>double loophole</u> because corporations can deduct interest and other costs associated with earning the dividend income while enjoying tax free income.

3) SB 455 was carefully drafted to insure that in virtually all cases Montana would tax dividend income only once.

To these reasons, I would add that the taxation of dividends is a standard practice in nearby Western states with similar corporation taxes. North Dakota, Idaho, California, Oregon, and Utah all currently include dividends in corporate income.

In its original form, SB 455 provided an equitable and evenhanded method for taxing dividend income. We see no justifiable reason for failing to treat the dividends of multistate and multinational corporations as income just as it is treated as income for individuals.

Distribution Formula -- General Questions

The purpose of the distribution formula is to provide local governments with greater fiscal stability and to increase their revenue. Fiscal stability is improved in two ways:

1) By allocating a share of all corporation tax receipts to counties, the formula provides a revenue base that is much more stable than the corporation tax payments of each county's financial institutions.

2) The bill will eliminate the liability of local governments for future refunds of back taxes to financial institutions. A list by county of the $763,243 in refunds paid by local governments in 1983 and 1984 is attached (Attachment D). Under current law, local governments are liable for refunds of back taxes resulting from either legal changes or from net operating losses being carried back three years.

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The formula increases revenue to local governments because it ties local government receipts to a base that is anticipated to grow in the future. Anticipated growth in corporation tax receipts is the reason that no counties will lose revenue and a large majority of the counties will gain. The formula does not increase the taxes of any corporation. Instead, it merely divides corporation tax receipts between state and local governments.

I am attaching the estimated distribution of revenues to local government under two versions of SB 455 with the 100% hold harmless provision (Keenan amendment). One version is with the Brown amendment, and the other version is without it. (Attachment E)

Distribution Formula -- Long Term and Rural County Questions

While the Department could provide you with estimates of the amount of corporation revenue that might be distributed to counties from 1988 through 1990, we hesitate to do so because of the precarious nature of such long term forecasts. Such estimates, which are related to total U.S. corporate profits, are subject to many unpredictable factors such as the accuracy of national forecasts of U.S. profits, changes in federal or state corporate tax laws, and general business fluctuations. We know of no acceptable methodology for making accurate estimates beyond the next biennium, and we trust that you would also find the methodology involved in such forecasts to be unacceptable.

With respect to rural counties, we have hard data indicating that, contrary to your fear, rural counties will benefit substantially from SB 455. If you review Attachment D, you will find that rural counties, especially Eastern Montana counties, were required to pay among the largest refunds to banks in 1983 and 1984. Under the bill, this refund liability is eliminated for the future.

Current economic trends point to substantial future declines in bank tax revenue received by rural counties under current law. These declines are attributable to worsening economic conditions in 1984 in rural counties. A few bank tax returns have now been filed this spring for 1984 income, and a pattern is beginning to emerge. Financial institutions in rural areas are now incurring losses, and those losses will translate into little or no current revenue from banks and into refund claims for back taxes paid from 1982 through 1984.

Attachment F lists the results for four counties for which returns showing financial institution losses have already been received this spring. Three of the four counties are rural counties. SB 455, by insuring counties a base level of revenue, will prevent revenue losses that rural counties will otherwise experience in the next biennium.

The one urban county on this list is the urban county most dependent on agriculture and most affected by worsening agricultural economic conditions.

Stated differently, in the next biennium under current law the gap between bank tax receipts of rural and urban counties will grow as rural receipts fall and urban receipts remain stable or increase. SB 455 will narrow that gap by providing a floor for each county.

Combined and Consolidated Returns

Attachment G summarizes the differences and similarities between combined and consolidated returns.

A consolidated return by definition creates a new entity for tax purposes that will file a single return. Therefore, it is necessary that every member in the consolidated group must be qualified to do business in Montana and operate exclusively in Montana. If that were not the case, Montana would lack a legal jurisdiction to tax the consolidated entity. Thus, a consolidated return is appropriate to corporate groups operating entirely within Montana.

If the operations of any member of an affiliated corporate group are conducted both within and outside Montana, the group would be required to report its activities under Part 3, the apportionment section of the corporation tax law. Under this part, the group may file a combined report if it constitutes a unitary business. Although there are similarities between combined and consolidated returns, there are important distinctions between the two. Under a combined report, each corporation in the group continues to file a separate return. There are also different stock ownership requirements for combined and consolidated returns. Other differences are noted in the attachment.

Because combined reports are specifically provided for under the section of law dealing with multistate and multinational corporations, corporate groups operating entirely within Montana cannot file a combined report.

There is a key similarity between the two reports. Under both, intercompany dividends are eliminated in the calculation of taxable income. Multistate and multinational corporations have available a combined report under current law. Montana corporations currently do not have available the functional equivalent: the consolidated return. By expanding the availability of consolidated returns, SB 455 places Montana corporations on an equal footing with respect to the tax treatment of dividends. The net effect is to insure in nearly all cases that dividend income is taxed only once by Montana for corporations of all types.

The Department of Revenue has legally restricted discretion to determine which corporations can file combined reports. We are responsible for making factual judgments as to whether or not a corporate group meets the criteria for a combined report. The key requirement for a combined report is that the group must conduct a unitary business. The criteria for a unitary business are summarized in Attachment H. The Department's factual judgments are subject to review in the courts. Corporations have challenged these judgments in court, but unlike the experience in other states, the Department's determinations of unitary businesses have never been overturned.

If a corporate group successfully establishes that it is a unitary business, it can insist on filing a combined report, and the Department has no authority to prevent that filing.

If a multistate or multinational corporate group is a unitary business, then its combined report will eliminate intercompany dividends irrespective of the Brown amendment. The same would be true under SB 455 for Montana corporate groups qualifying for consolidated returns.

If a corporate group is not eligible for a combined or consolidated report, dividends would be taxed to the receiving corporations under the original version of SB 455. With the Brown amendment, these dividends would not be taxed except for portfolio dividends.

No state simultaneously requires a combined report and taxes intercompany dividends within those reports. Montana does not do that, nor would it under SB 455 in any version. By definition, a combined report eliminates the taxation of intercompany dividends.

Several states, however, do tax intercompany dividends when a combined report is not being filed. As already noted, this is the practice in the nearby states of North Dakota, Idaho, California, Oregon, and Utah. There are others as well. Under the original version of SB 455, Montana would conform to a common practice of a) elimination of intercompany dividends when a combined or consolidated report is filed and b) taxation of intercompany dividends when a combined or consolidated report is not filed.

Combination of Features in SB 455

The features of SB 455 are interrelated. Allowing consolidated returns is a direct result of the proposal to subject dividends to taxation. Without that provision, intercompany dividends would be taxed to Montana corporate groups when they are not taxed to multistate and multinational corporate groups comprising a unitary business. The consolidated return provision places corporations of different types on a equal footing with respect to the taxation of dividends. It insures that in virtually all cases, Montana will tax dividends to corporations only once. (This topic was discussed further in the letter to Rep. Gilbert.)

Because SB 455 in its original form closes a tax loophole, it raises additional revenue. Because the added revenue comes almost entirely from multistate and multinational nonfinancial corporations, local governments would not receive any significant share of this revenue under the current law. The distribution formula provides a method for sharing that additional revenue with local government. It is a standard legislative practice to provide in the same bill for both raising revenue and for distributing that revenue.

Sincerely,

John D. LaFaver
Director

ATTACHMENT A

EFFECT ON CORPORATIONS OF TAXING SECTION 243 - PORTFOLIO TYPE DIVIDENDS

1983 RETURNS FOR 1982 INCOME

	TAX EFFECT
1.	$ 278.00
2.	6,575.00
3.	484.00
4.	659.00
5.	2,962.00
6.	582.00
7.	45,240.00
8.	46,427.00
9.	216.00
10.	205.00
11.	71.00
12.	367.00
13.	12,285.00
14.	156.00
15.	6,037.00
16.	2,410.00
17.	2,897.00
18.	9,491.00
19.	7,086.00
20.	197.00
21.	22.00
22.	5,522.00
23.	3,770.00
24.	76.00
25.	6,293.00
26.	15,866.00
27.	4,053.00
28.	4,248.00
29.	40,500.00
30.	3,739.00
31.	914.00
32.	66,068.00
33.	1,220.00
34.	3,225.00
35.	1,989.00
TOTAL	$302,130.00

The above corporations and tax effects were identified by auditors as they reviewed 1983 returns. Because these are manual records, 100% accuracy cannot be assured, but we believe the list is as complete a list as can be compiled.

ATTACHMENT B

CORPORATIONS PRIMARILY AFFECTED BY SB455
AND THE BROWN AMENDMENT

1984 RETURNS - 1983 INCOME

Corporation	Senate Bill 445 Without Brown Amendment (80% Owned Subsidiary Dividends Plus Portfolio Dividends)	Senate Bill 455 With Brown Amendment (Portfolio Dividends Only)
1.	$1,576,000	$ -0-
2.	95,000	6,200
3.	11,400	11,400
4.	2,100	-0-
5.	152,000	-0-
6.	17,000	100
7.	10	10
8.	527,000	2,200
9.	54,000	54,000
10.	-0-	-0-
11.	-0-	-0-
12.	-0-	-0-
13.	120,000	120,000
14.	21,000	70
15.	-0-	-0-
16.	-0-	-0-
17.	11,000	5,400
18.*	1,822	1,822
19.	-0-	-0-
20.	5,600	300
21.	1,300	1,300
22.	220	220
23.	-0-	-0-
24.	245	245
25.	-0-	-0-
26.	800	800
27.	10,000	10,000
28.	65,000	-0-
29.	-0-	-0-
30.	-0-	-0-
31.	4,000	4,000
32.	1,000	1,000
33.	1,100	1,100
34.	44,000	-0-
35.	-0-	-0-
36.	42	42
37.*	1,200	1,200
38.	-0-	-0-
39.	-0-	-0-
40.	-0-	-0-
41.	-0-	-0-
42.	640	640
43.	-0-	-0-
44.*	600	600
45.*	750	750
46.	160,000	6,075
47.	40,000	2,030
48.	18,144	162
Total	$2,942,973	$ 231,666

* Exclusively Montana corporations. They are affected only by taxation of portfolio dividends and not by taxation of 80% subsidiary income.

ATTACHMENT C

COP

April 15, 1985

Rep. Bob Gilbert
House of Representatives
State Capitol
Helena, Montana 59620

Dear Rep. Gilbert:

Thank you for the opportunity to clarify a number of issues concerning SB 455.

Your questions concerning consolidated returns cannot be answered without first discussing the dividends proposed to be taxed in the original version of the bill. The consolidated returns provision was a result of the proposal to include dividends in corporate net income.

The proposal to tax "Section 243, 244, and 245" dividends was made to close an inequitable tax loophole. The exemption of these dividends was never specifically enacted by the Montana Legislature. Instead, the exemption was a by-product of the Supreme Court's decision in the Baker Bancorporation case. This exemption is a loophole because dividends are income, and income is supposed to be subject to tax. In fact, in some cases a <u>double</u> loophole exists. If a corporation borrows money directly or indirectly to finance a stock investment, the interest expense is deductible, but the dividend income is not taxable! It is inequitable to exempt these dividends for corporations while individuals are required to pay tax on the dividends they receive.

In the overwhelming majority of cases, corporations would be taxed only once on dividends if this loophole were closed. Unless the loophole is closed, the share of dividends of multistate and multinational corporations attributable to Montana will escape state taxation entirely.

The consolidated returns provision was proposed to eliminate the bulk of those limited cases where income represented by dividends might be taxed more than once by Montana's corporation license tax. These cases involve jointly owned corporations operating exclusively in Montana. During and after the 1983 session, the Montana Bankers Association and the Taxation Committee of the

Montana CPA Society (the latter speaking primarily for non-financial corporate clients) voiced their opposition to the taxation of Section 243, 244, and 245 dividends unless Montana corporations were provided a mechanism for insuring that dividend income was taxed only once. That mechanism is the consolidated return. Allowing consolidated returns for Montana corporations has the effect of placing Montana corporations on the same footing as multistate and multinational corporations with respect to dividend income. As originally drafted, SB 455 with both its dividend and consolidated returns sections provided an equitable and evenhanded method for taxing dividend income only once in Montana for nearly all corporate taxpayers.

With this background, I will address your specific questions:

CONSOLIDATED RETURNS

1. **Of the $300,000-$500,000 which will be lost to the state if this section is enacted, which banks stand to gain the most?**

   It is important to clarify first that banks are not the only beneficiaries of the consolidated returns proposal. Our best judgment is that half of the revenue lost by the state will be gained by non-financial corporations. The other half will be gained by financials.

   Because of confidentiality statutes, I cannot list the banks or other corporations that would benefit from the provision. Generally, the benefit would be greater the larger the size and extent of the corporate group, so long as all parts of the corporate group operated exclusively in Montana.

   The Montana Bankers Association could arrange for the voluntary release of the names of the banks that would benefit. Barring that method, there are extraordinary procedures under law for the release of the names of the corporations, and those procedures could be discussed if necessary.

2. **How important is it for the banks to be able to file consolidated returns?**

   The consolidated returns provision is important if Section 243, 244, and 245 dividends are taxed, as well they should be. A consolidated return allows a jointly owned corporate group operating solely in Montana to eliminate intercorporate dividends just as multistate/multinational corporate groups can eliminate intercorporate dividends through a combined report. The end result would be that Montana would tax only once the dividend income of nearly all Montana and out-of-state corporations. As discussed earlier, it has the effect of treating corporate taxpayers alike for dividend income. Again, this result is important for Montana corporations in a variety of businesses, not just those in banking.

3. **Why is the language on lines 1-4 of page 18 (regarding eligibility to file consolidated returns) so narrowly drawn? Does this language favor one bank or bank system over another? Please explain the history behind this language.**

   The language in the consolidated returns section applies to those businesses operating solely in Montana because businesses operating both in and outside of Montana are treated under a different portion, "Part 3," of the corporation license tax law. Part 3 provides for apportioning income between Montana and the rest of the world for multistate/multinational businesses. Those businesses have available a combined report that allows for the elimination of intercorporate dividends and the offsetting of profits and losses of subsidiaries.

   Corporate groups operating entirely in Montana do not have available the functional equivalent of a combined report. The consolidated returns provision in SB 455 provides them with that functional equivalent. The language applies only to the entities operating solely in Montana because those are the only entities for which a consolidated return is relevant. There are additional legal reasons why a consolidated return must apply only to the Montana corporations. Those reasons relate to the extent of Montana's taxing authority. However, the policy reason for limiting consolidated returns to Montana corporations is to treat both Montana and multistate/multinational firms in a similar with respect to dividends.

   The language does not favor any multicorporate group over any other multicorporate group, banking or otherwise.

4. **Why has the Department of Revenue resisted financial institutions from filing consolidated returns in the past? What is the justification for allowing this in 1985 with a 300,000 to 500,000 price tag? Do you expect to eventually receive additional monies or will this revenue foregone continue indefinitely?**

Historically, the Department has not allowed consolidated returns for corporations in all types of businesses, not just banks. This position was adopted because the current law is a vague, discretionary statute. The law provides too little guidance for the Department to distinguish between one type of corporation or another. In recent years, bills were considered that would have both clarified and liberalized the consolidation statutes. These bills were rejected. Absent legislative clarification of the law, the Department has taken a restrictive approach to its administration. Since 1983, the statute has specifically prohibited financial institutions from filing consolidated returns because of the distribution of 80% of their corporation taxes to the counties in which they operate. Under the current distribution method, it is inappropriate to allow profits and losses of banks in different counties or of bank and non-bank enterprises to offset each other. Under the proposed SB 455 distribution method, this reason for prohibiting consolidated returns for financial institutions is eliminated.

The general justification for allowing consolidated returns in conjunction with the taxation of all dividends has been discussed above.

The revenue lost from consolidated returns would be an ongoing, annual cost. We, of course, anticipated that this revenue loss would be regained severalfold by the taxation of all corporate dividends. The consolidated return and dividend taxation provisions of the original bill are companion measures that go together hand in hand. The dividend section should be restored to the Senate version of the bill so that it once again is a consistent package.

5. **Please advise what other states in the region allow or do not allow the filing of consolidated returns, and is the language restricting the applicability similar to other regional states?**

Other states in the region also allow consolidated returns, but of those that do, one half have provisions differing from federal rules. The following chart summarizes the highlights:

State	Corporate Income Tax Imposed?	Consolidated Returns Allowed?	State Rules the Same as Federal?
Alaska	yes	yes	yes
Arizona	yes	yes	no
California	yes	no	N/A
Colorado	yes	yes	no
Hawaii	yes	yes	no
Idaho	yes	yes	yes
Minnesota	yes	no	N/A
Nebraska	yes	yes	no
Nevada	no	N/A	N/A
New Mexico	yes	yes	yes
North Dakota	yes	yes	yes
Oregon	yes	no	N/A
South Dakota	no	N/A	N/A
Utah	yes	yes	no
Washington	no	N/A	N/A
Wyoming	no	N/A	N/A

The limits on consolidations in other states are generally more restrictive than federal rules, and are designed to have an effect similar to the language proposed in SB 455.

DISTRIBUTION FORMULA

1. **How was the formula derived? Please attach a revised and up to date table.**

The original distribution formula in SB 455 was the one developed for SB 203. That formula resulted from consultation among the sponsor, local government associations, and the Montana Bankers Association. The Department responded to questions by these parties on the effects of distribution alternatives on counties.

I have attached tables showing the estimated distribution of revenues under the bill in its current form and under the bill if amended to restore the full taxation of dividends. Under the current form of SB 455, 33 counties in FY '86 and 36 counties in FY '87 are expected to receive more revenue than in the base years. If amended to restore dividend taxation, 35 counties in FY '86 and 40 in FY '87 are estimated to gain. Restoring the full taxation of dividends will distribute over $350,000 more to counties in the next biennium than the current form of the bill.

2. Although the floor amendments insure that the "lesser populated" counties will not lose any money under this bill, how much disparity do you estimate will there be between the sparsely populated and the highly populated counties in 1988? 1990? How likely is it that the sparsely populated counties will see little, if any, additional funds in the next 5-10 years if this bill passes?

   We have not attempted to estimate the effect into the next two bienniums, and to do so would be difficult under either the current law or the proposed law.

   We believe that the sparsely populated rural counties will actually be gaining revenue in the next biennium over what they would receive under current law. The base years that fix the guaranteed amounts of revenue to each county were relatively good years for banks in the rural counties. Oil exploration was relatively strong, and the agricultural sector was in better shape than present. In the next two years, it is likely that banks in those areas will report either little profit or no losses. That pattern for rural banks is already emerging in the returns being filed during this session.

   Under present law if banks report losses, rural counties will not only not receive any current revenue, but they will also have to refund some of the taxes collected in 1983 and 1984. The refunds will occur because corporations can carry losses back three years on their returns.

   Under SB 455, counties will not have to make any future refund payments caused by future bank losses. The bill guarantees rural counties the relatively favorable amounts of money they received in 1983 and 1984. Thus, rural counties are likely to gain revenues from the very outset under SB 455.

3. **Who have been the principal advocates for the change in the distribution formula? What was the position of the Department on this issue? When preparing the fiscal note, did you analyze any one time or continuing expenditures to implement the new distribution formula?**

   The principal advocates for changing the distribution formula in the bill have been legislators from rural counties. The various versions of the hold harmless clause were added at their initiative.

The Department has been neutral on the various versions of the formula. We have attempted to provide technical advice and data whenever requested.

The Department of Commerce would implement the distribution formula. They anticipate, at most, 100 hours annually to make these distributions. The cost of administration is, therefore, insignificant.

4. **On page 7 of the bill you have inserted language which requires that "on May 1, 1986 and May 1, of each succeeding year . . ." that the grant be distributed. Why was this date selected.**

That language was inserted by the House Tax Committee. The committee was presented differing views on the subject. Some parties advocated an earlier date, and others preferred a later date. My understanding is that the committee chose a compromise date.

Sincerely,

/s/ John D. LaFaver

John D. LaFaver
Director

COUNTY REFUNDS
1983 and 1984

COUNTY	REFUND
Powder River	$ 26,835
Gallatin	6,257
Teton	37,061
Roosevelt	88,096
Richland	103,385
Lake	34,398
Lewis and Clark	13,362
Valley	20,625
Cascade	48,342
Fergus	3,489
Hill	27,077
Beaverhead	16,426
Silver Bow	28,712
Missoula	12,767
Powell	6,166
Pondera	1,631
Stillwater	6,685
Madison	13,321
Blaine	12,029
Sweet Grass	15,423
Park	37,205
Richland	74,704
Daniels	49,329
Fallon	15,537
Yellowstone	1,578
Musselshell	8,959
Carbon	22,019
Mineral	0
McCone	31,825
TOTAL	$763,243

ATTACHMENT E

DISTRIBUTION TO COUNTIES UNDER SB455 W/O BROWN AMENDMENT

100 PERCENT HOLD HARMLESS

	AVG FY83-84 DISTRIBUTION	FY86 PROPOSED	DIFF.	FY87 PROPOSED	DIFF.
BEAVERHEAD	34964	46929	11965	50740	15776
BIG HORN	60805	61413	608	67260	6455
BLAINE	38534	38534	0	40710	2176
BROADWATER	2734	18316	15582	20060	17326
CARBON	35002	45790	10788	50150	15148
CARTER	21641	21641	0	21641	0
CASCADE	330141	437970	107829	479668	149527
CHOUTEAU	60750	60750	0	60750	0
CUSTER	101031	101031	0	101031	0
DANIELS	17644	17644	0	17644	0
DAWSON	72640	72640	0	74340	1692
DEER LODGE	34790	61951	27161	67850	33060
FALLON	40824	40824	0	40824	0
FERGUS	68380	69493	1113	76110	7730
FLATHEAD	210442	287670	77228	315058	104616
GALLATIN	111849	249422	137573	273169	161320
GARFIELD	12180	12180	0	12180	0
GLACIER	44480	60335	15855	66080	21600
GOLDEN VALLEY	0	5926	5926	6490	6490
GRANITE	13200	14545	1345	15930	2730
HILL	75690	100200	24510	109739	34049
JEFFERSON	5667	42019	36352	46020	40353
JUDITH BASIN	25688	25688	0	25688	0
LAKE	53529	106126	52597	116229	62700
LEWIS AND CLARK	134573	243496	108923	266679	132106
LIBERTY	20	12929	12909	14160	14140
LINCOLN	11295	98504	87209	107969	96674
MADISON	22386	31245	8859	34220	11834
MCCONE	11238	15084	3846	16520	5282
MEAGHER	16519	16519	0	16519	0
MINERAL	8530	19394	10864	21240	12710
MISSOULA	107889	406725	298836	445448	337559
MUSSELSHELL	46331	46331	0	46331	0
PARK	77161	77161	0	78470	1309
PETROLEUM	0	3771	3771	4130	4130
PHILLIPS	43029	43029	0	43029	0
PONDERA	79816	79816	0	79816	0
POWDER RIVER	40	13468	13428	14750	14710
POWELL	8617	36632	28015	40120	31503
PRAIRIE	36880	36880	0	36880	0
RAVALLI	64358	129829	65471	142189	77831
RICHLAND	86029	86029	0	86730	701
ROOSEVELT	88403	88403	0	88403	0
ROSEBUD	65319	71648	6329	78470	13151
SANDERS	30639	49022	18383	53690	23051
SHERIDAN	46907	46907	0	46907	0
SILVER BOW	125219	194474	69255	212989	87770

STILLWATER	34755	34755	0	34810	55
SWEET GRASS	8535	17777	9242	19470	10935
TETON	24700	35016	10316	38350	13650
TOOLE	73349	73349	0	73349	0
TREASURE	2548	5387	2839	5900	3352
VALLEY	18595	53871	35276	59000	40405
WHEATLAND	17777	17777	0	17777	0
WIBAUX	6670	8619	1949	9440	2770
YELLOWSTONE	583805	627057	43252	686757	102952
	3362545	4727430		5083860	

ATTACHMENT E

DISTRIBUTION TO COUNTIES UNDER SB455 WITH BROWN AMENDMENT

100 PERCENT HOLD HARMLESS

	AVG FY83-84 DISTRIBUTION	FY86 PROPOSED	DIFF.	FY87 PROPOSED	DIFF
BEAVERHEAD	34964	44023	9059	48488	13524
BIG HORN	60805	60805	0	64168	3363
BLAINE	38534	38534	0	38959	425
BROADWATER	2734	17405	14671	19197	16463
CARBON	35002	43511	8509	47994	12992
CARTER	21641	21641	0	21641	0
CASCADE	330141	416173	86032	459044	128903
CHOUTEAU	60750	60750	0	60750	0
CUSTER	101031	101031	0	101031	0
DANIELS	17644	17644	0	17644	0
DAWSON	72640	72640	0	72640	0
DEER LODGE	34790	58868	24078	64932	30142
FALLON	40024	40024	0	40024	0
FERGUS	60380	60380	0	72037	4157
FLATHEAD	210442	273353	62911	301512	91070
GALLATIN	111847	237007	125160	261421	149574
GARFIELD	12180	12180	0	12180	0
GLACIER	44480	57333	12853	63239	18759
GOLDEN VALLEY	0	5631	5631	6211	6211
GRANITE	13200	13821	621	15245	2045
HILL	75690	95213	19523	105021	29331
JEFFERSON	5667	39928	34261	44041	38374
JUDITH BASIN	25680	25680	0	25680	0
LAKE	53529	100844	47315	111232	57703
LEWIS AND CLARK	134573	231378	96805	255213	120640
LIBERTY	20	12286	12266	13551	13531
LINCOLN	11295	93677	82382	103327	92032
MADISON	22386	29690	7304	32749	10363
MCCONE	11238	14333	3095	15810	4572
MEAGHER	16519	16519	0	16519	0
MINERAL	8530	18428	9898	20327	11797
MISSOULA	107889	386483	278594	426295	318406
MUSSELSHELL	46331	46331	0	46331	0
PARK	77161	77161	0	77161	0
PETROLEUM	0	3583	3583	3952	3952
PHILLIPS	43029	43029	0	43029	0
PONDERA	79816	79816	0	79816	0
POWDER RIVER	40	12797	12757	14116	14076
POWELL	8617	34809	26192	38395	29778
PRAIRIE	36880	36880	0	36880	0
RAVALLI	64358	123367	59009	136076	71718
RICHLAND	86029	86029	0	86029	0
ROOSEVELT	88403	88403	0	88403	0
ROSEBUD	65319	68082	2763	75096	9777
SANDERS	30639	46583	15944	51381	20742
SHERIDAN	46907	46907	0	46907	0
SILVER BOW	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

STILLWATER	34755	34755	0	34755	0
SWEET GRASS	8535	16093	8358	18633	10098
TETON	24700	33273	8573	36701	12001
TOOLE	73349	73349	0	73349	0
TREASURE	2548	5119	2571	5646	3098
VALLEY	18595	51190	32595	56463	37868
WHEATLAND	17777	17777	0	17777	0
WIBAUX	6670	8190	1520	9034	2364
YELLOWSTONE	583005	595049	12044	657229	74224
	3962545	4549000		4905000	

COUNTIES CURRENTLY LIABLE FOR REFUNDS OF TAXES PAID ON RETURNS FILED FOR THREE PREVIOUS YEARS BECAUSE OF LOSSES ON RETURNS FILED IN THE SPRING, 1985

		Refund From State	Refund From County
1.	Wibaux Co.	$ 1,475	$ 5,832
2.	Dawson Co.	1,095	4,486
3.	Cascade Co.	13,006	52,026
4.	Fergus Co.	502	2,007
	Total	$16,078	$64,351

Most returns for 1985 have not been filed. This is merely an early indication of a trend emerging of declining bank tax revenues and refunds in 1985.

SIMILARITIES BETWEEN COMBINED AND CONSOLIDATED RETURNS

1. All intercompany dividends are eliminated.
2. All intercompany transactions are eliminated (sales, expense, etc.)
3. Total income and expense of all companies are included in the return, including companies with losses.

DIFFERENCE BETWEEN CONSOLIDATED AND COMBINED RETURNS

Consolidated Returns

1. 80% ownership of all members of the consolidated group.
2. File one return under the name of the parent corporation.
3. Must be unitary (current law, would be repealed by S.B. 455).
4. All members of the affiliated group must operate exclusively in Montana.
5. Permission to file a consolidated return must be obtained from the Department of Revenue (current law, would be repealed by SB455).

Combined Returns

1. 50% or more ownership of members included in the combined return.
2. Each member of the combined group doing business in Montana computes its tax if filed a separate Montana Corporation License Tax return.
3. Must be unitary.
4. Taxpayers are not required to obtain permission to file a combined return. The Department may require, or the taxpayer may demand, that a unitary return be filed for all members of an affiliated group that are determined to be unitary.
5. It is not necessary for members of the combined group to be doing business in Montana.
6. Consolidated returns are by statutory construction, whereas combined returns are viewed more as an accounting technique not specifically provided for by statute.
7. Corporate groups operating exclusively in Montana are not eligible to file consolidated returns.

CRITERIA FOR DETERMINING IF A GROUP OF AFFILIATED CORPORATIONS ARE UNITARY FOR PURPOSES OF FILING A COMBINED RETURN

1. Unity of Ownership - More than 50% of the component parts of the unitary business must be commonly owned, either directly or indirectly. (This requirement remains as a prerequisite to a finding that a component is unitary with other components of a business.)

2. Unity of Operation - This quality is evidenced by central purchasing, advertising, accounting, management, etc. (These central activities constitute a "flow of value," the term which the U.S. Supreme Court has most recently used in defining a unitary business.)

3. Unity of Use - This quality is evidenced by a centralized executive force and by a centralized general operations system. (This centralization also creates a flow of value.)