MINUTES OF THE MEETING
REVENUE ESTIMATING TAXATION SUBCOMMITTEE
50TH LEGISLATIVE SESSION
HOUSE OF REPRESENTATIVES

February 9, 1987

The meeting of the Revenue Estimating Taxation Subcommittee was called to order by Chairman John Harp on February 9, 1987, at 11:30 a.m. in Room 312-D of the State Capitol.

ROLL CALL: All members were present. Also present were Terry Johnson, OBPP; Judy Waldron from the LFA and Reps. Bob Ream and Mike Kadas.

Mr. Tom Vasquez, consultant with the Policy Economics Group of Peat, Marwick, Mitchell & Company, Washington, D.C spoke on the impact of the Tax Reform Act of 1986 on Montana residents. (Exhibit a)

Rep. Harp said the committee was interested in the federal windfall relative to its effect on Montana authorities. They are putting a figure of sorts into a resolution to sue for corporations and an expansion base for the biennium sessions. Montana is talking about doing some reforms of their own. Sen. Neuman is working on that bill in the Senate and they are trying to figure out how this might interact with that. It is basically showing little more than what the DOR is showing. They are trying to do a fiscal year split since a federal fiscal ends September 30 and a state fiscal years ends June 30. Everyone there was interested in cash income to the state.

Mr. Vasquez explained that he had taken the state's estimates for certain provisions and arrived at the figures shown in exhibit #1.

Montana would get capital gains for 1986 on April 15, 1987. He was nervous about counting on that money for 1987. A lot of things are going on - all sorts of the end of the year games are being played. There has been a lot of shifting into 1986, so he advised not to count on that capital gain revenue. Money was shifted into 1986 instead of 1987. Gains will be offset by gaming things that they know were going on at the end of 1986.

Sen. Neuman said Montana has a proposed reform package that had a lot of different components in it. If Montana disallows for federal taxes, what happens?

Mr. Vasquez answered that federal taxes are being affected by standard deductions. Sixty - seventy percent of people itemize on their taxes. He had a rough idea of personal deductions and federal deductible items. He has to run those and provide them to the committee. Sen. Neuman further said Montana's reform package has a whole bunch of provisions. Given those assumptions, he asked Mr. Vasquez if he could provide some data as to what effect they would have since it was hard to use just one part.

Mr. Vasquez advised the Tax Reform Act of 1986 sets up provisions one by one that will change that. Losing some revenue, but at the same time, collecting some revenue. It would have to be a document very similar to what they have.

Sen. Neuman asked what guarantees Montana had in their agreement with Mr. Vasquez's firm. Mr. Vasquez advised it would not be covered under the existing agreement. They would charge $400 per simulation after the initial contract. Sen. Neuman asked if that simulation would include all of the provisions. Mr. Vasquez advised they would do only one or two provisions that way at $400 per provision. There would be an economy of scale for more provisions. It would be cheaper if there were more. They end up doing that for every state they do this for.

Sen. Neuman asked what the time frame for doing that would be. How long before you can get a return to Montana? Mr. Vasquez answered if you would call them with a provision, they could fax it back to you within one hour. They can do that very, very quickly.

Rep. Harp was interested in the Federal Act. Personal exemptions were increased, but the taxable base on the federal level was really expanded. What was the thinking back in D.C. when it was put together? It was neutral in a period of five years. What drove it?

Mr. Vasquez answered they thought the 1981 Act cut business taxes too far. The ACRS involved corporate and individuals. Reagan wanted to drive down tax rates. It was a notion of realignment. Did not want to go to the treasury every year for a shopping list. It was pressure to reduce rates further at that time in 1981. Once that was done, it was purely categorical, and came to 15% and 28%. It was all this notion of neutrality in five years, not anything more drastic than that.

Individual rates are now lower than corporate rates. In the next couple of years corporations will dissolve and go into partnership levels. Will see a lot of finagling around to make partnerships whose members will be limited to 35 persons but will eventually limit down to capital corporation. There will be a lot more tinkering with the tax law to cover the deficit.

On the defense side, the President agreed to a 3% real defense money, prior to that he was asking for 7 - 8%. Zero growth already in defense spending. They stayed with the same estimates of $60 billion in deficits now. He did not see a big push to take the rates back off. He sees a deficit picture of $65 to $70 billion into 1990. If the deficit pressure is taken away, then they would have a more reasonable time to figure out a tax. There should be some stability on tax credit.

Rep. Kadas said the revenue estimating committee average is about 5.3% on personal income revenue estimating - 5.3, 4.7, 5.0, 4.8. That is the proposal being used now. Pretty close to those for personal income; 4 - 5% is considerably lower than historical. That is showing a decline in personal income.

Rep. Harp remarked unless we lower our personal forecast of 1988-89.

Mr. Vasquez advised he did not care what economic forecast he did. They estimate 4.38 and you 5.4.

Rep. Kadas asked what Mr. Vasquez thought was going to happen in 1990-91. Mr. Vasquez thought growth would be up to 5.4 in 1989, and would continue to grow from a lesser income growth. No one was going to take the 3.8 figure. Rep. Kadas said it is built into our base. What will drive personal income growth? Mr. Vasquez answered capital gains will continue to produce growth. Terry Johnson said they assume the 4, 3.8, 5.4 are the personal side only. Rep. Harp said tax liability should be aware of that too.

Rep. Ream said shifting to the fiscal year gains, there is a big drop in the fiscal year, why is it 5.4 rather than 3.8? Mr. Vasquez said it may be wrong. It does not include provisions outside the model. Have to work these out a lot better.

Dave Boyer asked 43.8 and 54 - 34.40, in 1989, $54 million more, what are those numbers? Mr. Vasquez answered those are the liability that they simulated. They include federal deductible and everything. Over three years, $8.5-9 million should be the only difference between those numbers outside the fiscal year split. He did not trust the 43.8 and 54 figures. That is $10 million less than the 54 because you change from calendar years to the fiscal years.

Sen. Neuman thought with the feds not allowing the sales tax deduction, there would be a trend to getting away from sales tax. Would that be a legitimate argument? Mr. Vasquez thought it should be a legitimate argument. It is only deductible if you itemize; 20% of returns itemize. No one is bothered by an increase in sales taxes though.

Rep. Harp asked about tradeoffs in the program. Mr. Vasquez said 1981 was so far out of line. The idea was to go in and have the same tax rates on all industries and to get rid of investment tax credit. Non-capital federal tax - federal tax rate had not gone up very much at all. It has been offset by the federal rate reduction. On corporate side it is very, very difficult to estimate. It comes from a very narrowly selected industry base. Most states have no idea of what has been done with corporate rates. If it can be stopped, the fed will do it and the states will be coupled to it. He thought it may take a little time. It would be best to let it sit and see what happens. Bills on the hill will limit partnerships to 35 partners.

Rep. Sands asked why Montanans are going to see a decrease in their federal tax liability as a result of the federal tax reform when overall, it was supposed to be neutral. Mr. Vasquez said it was revenue neutral on the combined two. Depending on your mix of corporate activities, equal. It was not revenue on the individual income side. There is a loss of $130 million on the individual side and $130 million gain on the corporate side.

Sen. Lybeck asked if you could compare an individual income tax with the federal and the effect it can have on the nearby states? Mr. Vasquez answered if you allow the federal deductible totally, that makes your system a lot less progressive. Relative to the other states, you are on the regressive side. Federal deductibility is such a regressive state rate of about 2 1/2%. You have deductibility and have at the same time, the federal top rate going from 2 1/2% up to a little over 7%. That is a tremendous disincentive. It depends on which it is packaged with. The impact on marginal rates is very, very large. Rep. Harp said 11 - 8% would help a lot.

Dan Bucks said that is emphasizing the importance of packaging. It allows for deduction of income taxes paid in the prior year, wiping out our numbers. There are more parts in there that are integrating factors.

Rep. Ream asked since you have looked at a number of states, and apart from the sales tax issue, those states that see a greater federal pass through are states that have a more regressive income tax? Mr. Vasquez answered yes, it is the mechanics of the federal deductible that makes them regressive. Not much income left at the state level when out of $1.00 income, 50 cents goes to the federal. It is effectively a much lower rate and since you have a very progressive level, you almost have to have a fairly regressive state effect.

Rep. Kadas asked if in your report there is any way to pull out effective rate by income groups? Mr. Vasquez asked effective rates or marginal rates? Rep. Kadas said knowing the total amount of income, if that individual were given another $1 of income, how much would he have to pay? Mr. Vasquez answered would take marginal from 2 1/2 - 7, you want to look at the average marginal rate. Where you go from 2 1/2 - 7 is by eliminating deductible in the state. That would not have as much effect.

Rep. Harp said one of 13 states that is connected with the internal revenue thought that if they take the federal act through, under which provisions of that would we lose some of our benefits? We meet every other year and Congress could make some tremendous changes in one year and we would react to them in another year.

Rep. Harp told Mr. Vasquez his coming to Montana was appreciated and looked forward to seeing some of the numbers. Sen. Neuman said they will talk about what is in the reform taxes and give him some assumptions to work on. There will be a meeting at 1:30 to try to give Mr. Vasquez some of this information. It was to be in room 428A.

ADJOURNMENT: There being no further business to come before the committee, the hearing was adjourned at 12:30 p.m.

John Harp

REP. JOHN HARP, CHAIRMAN

DAILY ROLL CALL

HOUSE TAXATION REVENUE ESTIMATING SUBCOMMITTEE

50th LEGISLATIVE SESSION -- 1987

Date [illegible]

NAME	PRESENT	ABSENT	EXCUSED
REP. HARP	✓		
REP. ELLISON	✓		
REP. HARRINGTON	✓		
REP. SANDS	✓		
REP. SCHYE	✓		
REP. WILLIAMS	✓		
SEN. NEUMAN	✓		
SEN. BISHOP		✓	
SEN. HAGER	✓		
SEN. HIRSCH		✓	
SEN. LYBECK	✓		
SEN. SEVERSON	✓		

CS-30

IMPACT OF THE TAX REFORM ACT OF 1986 ON MONTANA RESIDENTS

MONTANA PERSONAL INCOME GROWTH

1985 to 1989

YEAR		PERSONAL INCOME (billion)
1985	actual	9.067
1986	projected	9.819
1987	projected	10.362
1988	projected	11.017
1989	projected	11.772

PERSONAL INCOME INCREASES

YEAR		% AVERAGE INCREASE
1985 to 1986	actual	8.3%
1986 to 1987	projected	5.5%
1987 to 1988	projected	6.3%
1988 to 1989	projected	6.9%
1985 to 1989	projected	6.75%

Source of Information: Paul Polzin - Director of Economic Forcasting at University of Montana Bureau of Economics Analysis