

MINUTES OF THE MEETING
TAXATION COMMITTEE
MONTANA STATE SENATE

February 17, 1987

The twenty-fifth meeting of the Senate Taxation Committee was called to order at 8:00 A.M. on February 17, 1987 by Chairman George McCallum in Room 325 of the Capitol Building.

ROLL CALL: All committee members were present.

CONSIDERATION OF SB 307: Senator Neuman, Senate District 21, presented the section of the bill dealing with corporation license and income tax revision. His written presentation is attached as Exhibit 1.

PROPOSERS: Dan Bucks, Deputy Director, Department of Revenue, gave testimony in support of this bill and his comments are attached as Exhibit 2.

Terry Murphy, Montana Farmers Union, gave testimony in support of this bill. He said we had our executive board meeting in Helena and he was able to present the entire bill at that time. It was thought the entire bill was generally favorable and they certainly have no problem with this portion whatsoever. When the committee gets to the coal tax section, he is against reducing that at all. The rest of the bill has a lot of merit but he cautions the committee to review the corporate license area carefully.

Kay Foster, on behalf of the Governor's Council on Economic Development, gave testimony in support of this bill. The business climate subcommittee of the Governor's Council met for 9 months and presented 7 recommendations to the council for their approval. Two of these recommendations were the corporation income tax revisions and revisions of the unitary tax. The Council felt broadening the tax base would promote economic growth through its impact on the business climate.

Gary Langley, Montana Mining Association, gave testimony in support of this bill. They would certainly welcome some relief in their tax burden and very much support the reduction in the corporation tax rate.

Bob Kelly, Chairman of the Governor's Transition Task Force, gave testimony in support of this bill. He was

appointed by the Governor to provide a broad review on how to make the economic climate in the state of Montana more attractive to business and to keep business in Montana. It was apparent to the task force that the state's mineral resource industry could not be abandoned and had to be more competitive in a world market. We also needed to add value to our existing Montana products. The state needs to establish a more equitable tax system, less dependent on natural resources. Appropriate tax incentives are needed to attract new business and to encourage expansion of old businesses. Even although the task force did not specifically recommend a reduction of the corporate license tax, it seems to follow the message of the task force and meets the overall objectives of the task force.

Don Reed, Montana Alliance of Progressive Policy, gave testimony in support of this section of the bill. He is in general support of the property tax income provisions of this bill and in support of the concept of broadening the tax base. His comments are directed toward the dividend income and the corporate income tax rate. He thinks it is a good idea to close loopholes and supports dealing with Section 243 dividends. With the corporate rates reduced, he hopes the revenue neutral rate is maintained. If the legislature decides it needs additional revenue, leaving the rate where it currently is would generate \$9.5 million of additional revenue. Whether it is 6% or 6.75%, our tax rate is still below the national average of 7.5%.

Eric Feaver, Montana Education Association, stood in support of this section of the bill.

OPPONENTS: Gary Carlson, Montana Society of CPA's, gave testimony in opposition to this area of the bill. He said our society is in favor of simplification of the tax laws of the state of Montana. He referred to Section 36 of the law proposed on page 73, and said they are opposed to the law proposed on the changes in NOL's. Many small businesses in Montana utilize NOL's in filing income tax returns. Specifically the elimination of the carry back and the change in carry forward from 7 to 3 years will impact small businesses. The history of NOL's in Montana from the period January, 1971 through December 31, 1975, were NOL's had a 3 year carry back and a 5 year carry forward, so small businesses had the opportunity of 8 tax years to use net operating losses. A change in January, 1975 to present, is that the carry back is 3 years and the carry forward is seven. The proposal in the Governor's bill reduces the utilization

of NOL's to a period of 3 years, which is a dramatic decrease. The federal NOL period is three years carry back and 15 years carry forward for a total period of 18 years to utilize net operating losses. Our profession believes this is a negative message to Montana businesses who are small corporations. With regard to Section 38, he would urge caution in alternative minimum tax area. This is uncharted waters from the standpoint of alternative minimum taxable income. He questions whether Montana should tie the alternative minimum taxable income to federal. There are instances in Montana where there is a significant difference between taxable income, federal versus state.

FURTHER PROPONENT: Gordon Morris, Montana Association of Counties, gave testimony in support of this bill. He believes sections 35 and 36 have merit and would ask for favorable consideration.

QUESTIONS FROM THE COMMITTEE: Senator Crippen asked Gordon Morris to explain the loss that cities receive on the carry backs.

Gordon Morris said the Department of Revenue currently collects the corporation tax and distributes that back to counties, cities and towns. On the carry back, over the three year period, there will be a change in net operating losses and then the Department of Revenue will notify counties that a refund is called for. Consequently they have to initiate the refund back to the banking institution, of whatever, but mostly banks.

Senator Crippen asked how that is handled to this point in time.

Gordon Morris said it is a problem that every county handles in its own way. Most make the refund out of current receivables.

Senator Crippen said you could anticipate and allow for that.

Gordon Morris said we could anticipate and appropriate for that but it is very difficult to determine.

Senator Crippen asked Mr. Carlson, given the elimination of the NOL carry back provision and the cyclical nature of the state, would he expect the hardship to carry on with the farmers and other types of cyclical businesses in the state.

Gary Carlson said he would agree they would be partly impacted by NOL's. Many small family ranch corporations have very significant NOL's.

Senator Crippen said for a new business your losses for the first few years are substantial and then after the business prospers you may make money. From the standpoint of the carry forward, the effect of that loss you have at the beginning will be a loss. We could have a scenario of a new business where in a five year period of business they would have absolutely no taxable income at all in the aggregate and would still end up paying tax.

Senator Eck asked Dan Bucks with regard to the repealer in section 93, which repeals the wage credit for new jobs, is it still true that credit has a small impact because relatively few people claim it.

Dan Bucks said yes, that is true, through the history of that credit, fewer than a dozen corporations have claimed it because of the way that credit is presented.

Senator Crippen asked Dan Bucks if the fiscal note has anything in it that would give the committee an idea of what the state would receive from the federal windfall if we didn't change the corporate tax structure.

Dan Bucks said he thought that was in the fiscal note.

Senator Crippen said you made a statement that the money that we are receiving from the change in the NOL/dividend structure is going to be passed on to the state by reducing corporate tax but the question that I have is are we really gaining that money by the reduction of the corporate tax or by the windfall tax.

Dan Bucks said the only way I can really show that is by looking at page 3 of the fiscal note which deals with the corporation license tax.

Senator Crippen said you still do not have the figures where we would be with the Federal Tax Reform Act if we did nothing.

Dan Bucks said we have provided a report to the legislature in relation to the Federal Tax Reform Act and the Executive Budget includes that revenue. Those are items that are not included in this particular bill.

Senator Crippen would like to see the windfall to the state without any change at all so that he has something to compare with.

Dan Bucks said yes.

Senator Eck asked Gary Carlson to expand on his statement that he questions the advisability of adopting the minimum tax on corporations and that the taxable income is different in Montana than it would be at the federal level.

Gary Carlson said the proposal that is in the Governor's bill has an alternative minimum tax rate that is exactly equal to the proposed corporate rate for all corporations. At the federal level the maximum corporate rate is being changed to 34% and the alternative minimum tax rate is going to be 21%. Deviations at the federal level as to the rate to be used on average minimum tax alters taxable income. The Montana proposal has the rate of 6%, calculated exactly on the proposed federal alternative minimum tax level. So the number for the determination of the alternative minimum tax in Montana will come directly from a form in the federal return and take 6% times that figure. Specific deductions that may be allowed at the federal level, may not be allowed at the state level.

FURTHER CONSIDERATION OF SB 307: Senator Neuman, Senate District 21, presented the section of the bill dealing with unitary taxation. His written comments are attached as Exhibit 1.

PROPOSERS: Dan Bucks, Deputy Director, Department of Revenue, gave testimony in support of this section of SB 307. His written comments are attached in Exhibit 2. He referred to a chart showing information on a Montana Retail Corporation and a Multi National Retailer. This chart is attached as Exhibit 3.

Terry Murphy, Montana Farmers Union, gave testimony in support of this section of the bill. He said we have always felt, in principle, the worldwide unitary approach was right but very difficult to deal with. He feels this approach is good in that it goes to a tax system that can be pretty well and easily defined and gives some incentives for the investment and creation of new businesses in Montana.

Eric Feaver, Montana Education Association, stood in support of this section of the bill.

Kay Foster, on behalf of the Governor's Council on Economic Development, gave testimony in support of this bill. The business climate subcommittee of the Council investigated the issue of the unitary tax and application by the state

of Montana. The Council felt that the elimination of the unitary red flag was necessary considering investment in Montana. She was not involved in the discussions on the waters edge method, but she would agree that the process developed for its election in this bill moves in the right direction for Montana.

Don Reed, Montana Alliance for Progressive Policy, gave testimony in support of this bill. A copy of his written statement is attached as Exhibit 4.

OPPONENTS: George D. Anderson, CPA, Helena, gave testimony in opposition to this section of the bill. A copy of his written statement is attached as Exhibit 5.

George Bennett, a lawyer from Helena, gave testimony in opposition to this section of the bill. The Governor's bill will do several things. It will remove the red flag of the unitary worldwide approach in Montana. It will put into place legislation similar to the state of California. He said one thing I think we can agree on is the unitary approach applied by Montana's red flag will have negative perception in the corporate world. He has practiced law in Helena for 30 years and has lived with the corporate tax and with the unitary tax and has had disputes over the unitary tax ever since. The corporate perception of the worldwide unitary tax is very real. The concept of worldwide taxation seems relatively simple. Property, payroll, and sales produce income. Therefore, you take the income of one business conducted worldwide and appreciate it to Montana. That sounds simple and fair, but it's a long way between theory and practice. Corporations believe that the states that use that type of practice are manipulating. Montana is one of the few states that still goes worldwide. We all agree we have got to do something about it. The question is will you address the Governor's bill or will you take a look at another bill in the House, HB 703. He feels HB 703 is the answer, patterned after Idaho and North Dakota bills.

Dennis Burr, representing the Montana Taxpayers Association, gave testimony in opposition to this section of the bill. He said this bill seems to put into law the current practice of the Department of Revenue with the unitary concept with foreign parent corporations. The problem with that concept is you are treating foreign parent corporations in a much more favorable manner than American corporations that do business. It would seem to him, the purpose of repealing the unitary method of taxation would be to encourage and stimulate investment in Montana and the best way to do that would be to treat both American and foreign corporations in the same manner.

QUESTIONS FROM THE COMMITTEE: Senator Crippen said in looking at the payroll only, see attached Exhibit 3, it would seem to him that the multi national retailer employs 20 times as many people as the Montana retailer, assuming salaries are equal. He asked Dan Bucks what the withholding would be for the multi national retailer.

Dan Bucks said off the top of his head, the multi national retailer would probably pay \$2,000 in income tax withholding.

Senator Crippen said his figures are that the multi national retailer would pay 20 times as much tax as the Montana retailer.

Dan Bucks said that is probably correct. The question here is really not whether they are employed for one or the other. The question is whether the market is shared by the different businesses or whether this retailer runs that retailer out of business.

Senator Crippen said your conclusion is we should not allow any national multi retailer to come in and take over the share of Montana retailers.

Dan Bucks said what we are saying is that we should have everybody competing on an equal playing field in Montana, with no one being favored over another.

Senator Crippen said they are employing 20 times the people and 20 times the money is going to the economy.

Senator Mazurek said the greatest complaints he has heard are about the method by which this is applied. He asked Mr. Anderson to comment on problems he has run into and what changes in the bill he would recommend for application to Montana.

George Anderson said one of the problems is it is very hard to determine what a unitary business is and the Department of Revenue makes no sense whatsoever on what they determine as a unitary business as far as this state is concerned.

Senator Mazurek asked if the problem is with existing statute or interpretation.

George Anderson said it is mostly a problem in interpretation of existing statutes.

Senator Mazurek asked if HB 703 addressed his concerns.

George Anderson said HB 703 does not particularly address that part of it. It would seem to him the Department of Revenue needs to interpret the law the way it should be. What is being done by the Department and what is being done under SB 307 does not remove the red flag.

Senator Mazurek said to Dan Bucks, he has difficulty with the distinction between foreign parent and U.S. parent. He asked if this will treat foreign parent corporations better than U.S. parent corporations.

Dan Bucks said the U.S. Supreme Court has ruled the worldwide unitary method to be fair and proper as it is applied to U.S. parent corporations and foreign subsidiaries. In the last part of the decision, there is a question as to whether or not the method can be applied to foreign parent corporations and they have not approved a method for the states as yet. As a practical matter, only a few states combine foreign parents. Montana did not combine foreign parents. Our conclusion is, we may not have the authority to reach beyond the international boundaries to foreign parent corporations.

Senator Mazurek said if that is the case, why would we treat the U.S. corporations in a less favorable light than the foreign corporations.

Dan Bucks said we believe that in practical circumstances in Montana that that particular situation does not arise to any significant or substantive degree. What does arise to any degree are those kinds of examples where you have in every industry in Montana, competition between multi corporations and small Montana corporations. The problem creates a special tax break for multi national corporations and creates unfair incentives compared to the small Montana businesses and that is where we have thousands of businesses.

Senator Mazurek said if that is the case, what have the other states done on this question.

Dan Bucks said he does not feel they have dealt with it very well or effectively.

Senator Neuman closed.

ADJOURNMENT: The meeting adjourned at 10:00 A.M.


SENATOR GEORGE MCCALLUM, Chairman

ROLL CALLTAXATION

COMMITTEE

50th LEGISLATIVE SESSION -- 1987

Date 2-17-87

NAME	PRESENT	ABSENT	EXCUSED
SENATOR CRIPPEN	✓		
SENATOR NEUMAN	✓		
SENATOR SEVERSON	✓		
SENATOR LYBECK	✓		
SENATOR HAGER	✓		
SENATOR MAZUREK	✓		
SENATOR ECK	✓		
SENATOR BROWN	✓		
SENATOR HIRSCH	✓		
SENATOR BISHOP	✓		
SENATOR HALLIGAN, VICE CHAIRMAN	✓		
SENATOR McCALLUM, CHAIRMAN	✓		

Each day attach to minutes.

(This sheet to be used by those testifying on a bill.)

NAME: GEORGE T. BENNETT DATE: 2/17/87

ADDRESS: 111 NO. MAIN HELENA

PHONE: 442-3691

REPRESENTING WHOM? W. R. GRACE

APPEARING ON WHICH PROPOSAL: SB 307 (Unitary Promissory Corporations
§§40 et seq.)

DO YOU: SUPPORT? AMEND? OPPOSE? X

COMMENT: Oppose the Unitary Promissory (§§40 et seq.)
as discriminatory to American or U.S. based
corporations; not based on California
approach.
Support H.B. 703 on same subject. H.B. 703
patterened after Idaho and North Dakota bills.

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

(This sheet to be used by those testifying on a bill.)

Technical Witness

NAME: MARY B CARLSON

DATE: 2/17/87

ADDRESS: Box 1147 Helena

PHONE: 442-3540

REPRESENTING WHOM? MT Society of CPAs

APPEARING ON WHICH PROPOSAL: SB 307

DO YOU: SUPPORT? AMEND? XXX OPPOSE?

COMMENT:

Amend Sec. 36 NO2 Changes to a
more favorable consideration for Corporations
with losses

Sec 38 Urge caution in alternative
minimum tax area - uncharted
water

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

corp. tax

YESTERDAY I PRESENTED TO YOU THE IDEA THAT THE BEST TAX POLICY FOR MONTANA IS A POLICY THAT REPLACES SPECIAL PREFERENCES FOR A FEW WITH AN EQUAL PREFERENCE FOR ALL. BY BROADENING THE TAX BASE AND LOWERING TAX RATES WE CAN PROVIDE INCREASED INCENTIVES FOR ECONOMIC GROWTH. TODAY WE WILL DISCUSS HOW WE CAN CARRY OUT THIS TAX POLICY IN THE CORPORATION TAX AREA.

THERE ARE REALLY THREE SUBJECTS TO DISCUSS:

- 1) LOWERING THE CORPORATION TAX RATE FROM 6.75% TO 6% BY BROADENING THE TAX BASE,
- 2) ADOPTING AN ALTERNATIVE MINIMUM CORPORATE TAX, AND
- 3) ELIMINATING THE STIGMA OF WORLDWIDE UNITARY WITHOUT VIOLATING THE FAIRNESS OF THE UNITARY TAX SYSTEM.

SB 307 WILL LOWER THE CORPORATION TAX RATE TO ITS LOWEST LEVEL SINCE 1969 -- 6%. THAT LOWER RATE WILL BENEFIT ALL 20,000 PLUS CORPORATIONS DOING BUSINESS IN MONTANA, AND AFTER THIS CHANGE MONTANA'S RATE WILL BE LOWER THAN NEARLY TWO-THIRDS OF THE STATES LEVYING A CORPORATION TAX.

THE LOWERING OF THE RATE WILL BE ACCOMPLISHED BY CLOSING A SPECIAL DIVIDEND LOOPHOLE AND LIMITING THE CARRYOVER OF LOSSES TO 3 FUTURE YEARS.

UNDER SB 307, ALL DIVIDENDS RECEIVED BY CORPORATIONS WILL BE TAXED ONCE, BUT ONLY ONCE. AT PRESENT, SOME DIVIDENDS ESCAPE TAXATION, AND MOST OF THOSE DIVIDENDS ARE RECEIVED BY A HANDFUL OF CORPORATIONS. IN FISCAL YEAR 1986, 12 CORPORATIONS RECEIVED A \$5.5 MILLION TAX BREAK BECAUSE OF THE DIVIDEND DEDUCTION.

SENATE TAXATION

EXHIBIT NO. 1

DATE 2-17-87

INSTEAD OF PROVIDING OVER \$5 MILLION OF TAX RELIEF TO A FEW COMPANIES, WE SHOULD PROVIDE THAT TAX RELIEF TO ALL CORPORATIONS THROUGH A LOWER TAX RATE.

TO MAKE CERTAIN THAT ALL DIVIDEND INCOME IS TAXED ONCE, BUT ONLY ONCE, A CREDIT WILL BE ALLOWED TO A MONTANA CORPORATE TAXPAYER RECEIVING DIVIDENDS FROM ANOTHER MONTANA CORPORATE TAXPAYER. THAT CREDIT REMOVES ANY POSSIBILITY OF DOUBLE TAXATION OF DIVIDENDS AT THE STATE LEVEL.

THE SECOND WAY THE CORPORATE RATE WILL BE REDUCED IS THROUGH LIMITING LOSS CARRYOVERS TO 3 FUTURE YEARS. LOSS CARRYOVERS MAY MAKE SENSE AT THE FEDERAL LEVEL WHERE CONGRESS HAS THE LUXURY OF NOT BALANCING ITS BUDGET. AT THE STATE AND LOCAL LEVEL, LOSS CARRYOVERS MAKE LESS SENSE. THE CORPORATION TAX IS A TAX ON THE PRIVILEGE OF DOING BUSINESS IN MONTANA, AND IN EXCHANGE FOR THE TAX, STATE AND LOCAL GOVERNMENTS PROVIDE SERVICES THAT SUPPORT ECONOMIC ACTIVITY. THOSE SERVICES MUST BE PROVIDED YEAR-IN AND YEAR-OUT ON A BALANCED BUDGET BASIS.

LOSS CARRYOVERS, ESPECIALLY CARRYBACKS TO PRIOR YEARS, DO NOT FIT AT THE STATE AND LOCAL LEVEL. IN FISCAL YEAR 1985, MONTANA STATE AND LOCAL GOVERNMENTS PAID BACK \$2.5 MILLION OF MONEY ALREADY COLLECTED AND SPENT ON SERVICES BECAUSE OF LOSSES CARRIED BACK TO PRIOR YEARS. FROM APRIL TO JUNE OF LAST YEAR, EIGHT COUNTIES ALONE WERE REQUIRED TO PAY BACK OVER \$500,000 IN REFUNDS -- MONEY THAT MAY NOT HAVE BEEN BUDGETED AND THAT HAD TO BE PAID OUT OF REDUCED SERVICES OR HIGHER PROPERTY TAXES.

TO PREVENT THE DISRUPTION OF STATE AND LOCAL SERVICES, LOSS CARRYOVERS SHOULD BE LIMITED, BUT THE MONEY SHOULD NOT BE SPENT BY GOVERNMENT. IT SHOULD BE RETURNED TO BUSINESS THROUGH A LOWER CORPORATION TAX RATE.

SENATE TAXATION

EXHIBIT NO. 1

DATE 2-17-87

BILL NO. S.B. 30

minimum tax

THE PROPOSED ALTERNATIVE MINIMUM TAX WILL ALSO HELP BROADEN THE MONTANA TAX BASE. THE STATE ALTERNATIVE MINIMUM TAX WILL BE PIGGYBACKED ON THE FEDERAL TAX IN A VERY SIMPLE MANNER. THE TAX WILL PROVIDE THE REVENUE FOR AN EXPANDED CAPITAL COMPANY CREDIT, STRIPPER AND TERTIARY OIL RELIEF, AND THE ELIMINATION OF NUISANCE TAXES.

stop

unitary

SB 307 RESOLVES THE ISSUE OF UNITARY TAXATION IN THE RIGHT WAY. IT REMOVES MONTANA FROM THE LIST OF WORLDWIDE UNITARY STATES BY GIVING CORPORATIONS AN OPPORTUNITY TO FILE WATER'S EDGE TAX RETURNS. THE BILL ALSO PREVENTS A MAJOR SHIFT OF THE TAX BURDEN TO SMALL BUSINESSES THAT ARE PRIMARY SOURCE OF NEW JOBS IN MONTANA AND THE NATION. FURTHER, IT PROVIDES AN INCENTIVE FOR LARGE CORPORATIONS TO INVEST IN MONTANA.

NOT ALL LARGE CORPORATIONS PREFER WATER'S EDGE TO WORLDWIDE UNITARY. BUT THOSE CORPORATIONS PREFERRING TO PAY ON A WATER'S EDGE BASIS WILL BE ABLE TO MAKE THAT CHOICE IN EXCHANGE FOR THE PAYMENT OF AN ELECTION FEE. THAT FEE PREVENTS A REVENUE LOSS AND TAX SHIFT TO SMALLER BUSINESSES. MOST OF THE FEE CAN BE EARNED BACK BY THOSE CORPORATIONS, BY INVESTING OR CREATING JOBS IN MONTANA.

IT IS SOUND TAX AND ECONOMIC POLICY TO REMOVE THE NEGATIVE PERCEPTION ASSOCIATED WITH WORLDWIDE UNITARY, BUT TO INSURE FAIR TREATMENT OF MONTANA'S SMALL BUSINESSES. ECONOMIC EXPERTS GENERALLY AGREE THAT SMALL BUSINESSES WILL CONTINUE TO PROVIDE THE NEW JOBS WE NEED. SMALL BUSINESSES SHOULD NOT BE PENALIZED BY CHANGES IN THE UNITARY METHOD.

AT PRESENT, THERE IS A GENERAL EQUALITY IN THE TAX BURDEN ON SMALL AND LARGE BUSINESSES IN MONTANA. SB 307 PRESERVES THAT EQUALITY. WE SHOULD NOT UPSET THE CURRENT BALANCE BY GRANTING SPECIAL TAX PREFERENCES AND A COMPETITIVE ADVANTAGE TO MULTINATIONAL CORPORATIONS OVER MONTANA BUSINESSES. EQUAL

SENATE TAXATION

EXHIBIT NO. 1

DATE 2-17-87

BILL NO. S.B. 307

TREATMENT OF ALL CORPORATIONS, NOT SPECIAL TREATMENT FOR A FEW SHOULD BE THE STANDARD WE SEEK.

Venture Capital

THERE ARE, THOUGH, EXCEPTIONS TO EVERY RULE. TAX BENEFITS SHOULD BE GRANTED ONLY IN CASES WHERE SUCCESS IN ACHIEVING LARGER PUBLIC BENEFITS IS WELL ASSURED. INCREASING VENTURE CAPITAL IN MONTANA IS SUCH A CASE. SB 307 WOULD DOUBLE THE RATE AND MAXIMUM AMOUNT OF THE TAX CREDIT THAT CAN BE CLAIMED FOR INVESTING IN A MONTANA CAPITAL COMPANY. IT WOULD INCREASE FOURFOLD THE AMOUNT OF CREDITS THAT CAN BE EARNED THROUGH ANY ONE COMPANY. IT WOULD MAKE AVAILABLE \$3 MILLION IN NEW TAX CREDITS AS WELL AS ALLOW THE USE OF UNUSED CREDITS FROM PRIOR YEARS.

UNDER THIS BILL, MONTANA CAPITAL COMPANIES WOULD CONTINUE TO FOCUS THEIR DEVELOPMENT EFFORTS ON MONTANA.

VENTURE CAPITAL ACTS AS A SPARK PLUG FOR ECONOMIC GROWTH. THE VENTURE CAPITAL INDUSTRY IS AN INFANT INDUSTRY IN MONTANA, AND SB 307 WILL HELP THAT VENTURE CAPITAL INDUSTRY MATURE INTO AN EFFECTIVE FORCE FOR BUILDING THE MONTANA ECONOMY.

SENATE TAXATION

EXHIBIT NO. 1

DATE 2-17-87

BILL NO. S.R. 20

SENATE TAXATION

EXHIBIT NO. 2
DATE 2-17-87
BILL NO. SB 307

TESTIMONY ON SB 307
THE MONTANA ECONOMIC AND TAX REFORM ACT OF 1987

Corporation and Unitary Tax Reform

Dan Bucks, Deputy Director, MT Department of Revenue
Senate Committee on Taxation, February 17, 1987

Mr. Chairman and Members of the Committee, this morning I will focus on two subjects:

- 1) the reduction in the corporation tax rate through base broadening, and
- 2) unitary taxation.

I will begin each subject with a section by section review of the relevant parts of the bill and then proceed to review background information and the rationale in each area.

Let us turn first to sections 35 through 39, the base broadening and rate reduction sections starting on page 71 of the bill.

Section 35 ties the corporation tax to this bill's general definition of the Internal Revenue Code. It also redefines net income to conform to changes made in the next two sections of the bill.

Section 36 does four things:

- 1) It ties deductions for ordinary business expenses directly to the Internal Revenue Code. This change assures taxpayers that their business expense calculations for federal tax purposes are proper for state purposes.
- 2) It provides that a corporation's net losses in 1987 and future years can be carried forward three years, but cannot be carried back to prior years. The revenue from this change helps reduce the corporation tax rate.
- 3) It allows losses from before 1987 to be carried back and carried forward just as they are now under current law (3 years back and 7 years forward).
- 4) It eliminates an unnecessary reference to energy deductions already allowed as ordinary business expenses.

Section 37 eliminates deductions for the water's edge election fee and for the dividend deduction allowed at the federal level under Sections 243, 244, and 245 of the Internal Revenue Code. The elimination of this dividend deduction contributes more than any other change to the reduction in the corporation tax rate.

Section 38 reduces the corporation tax rate to 6%. It also provides for a corporate alternative minimum tax based directly on the federal minimum tax.

Section 39 provides a credit to eliminate any possibility of double taxation of dividends. In conjunction with section 37, it guarantees that dividend income will be taxed once, but not more than once. In past sessions the effort to close the loophole has faltered not on the larger question of whether the bulk of these dividends should be taxed, but on the question of how to remedy the double taxation of a very small part of the dividends that flow from one Montana corporate taxpayer to another. The dividend credit in Section 39 solves that problem.

We checked that language with the corporate group most concerned with this issue in 1985. They assured us that Section 39 eliminated any potential for double taxation of dividends. With that problem solved, the way is open to improving the equity of the tax base and lowering tax rates.

There are related sections in the back of the bill repealing portions of current law. On page 146, Section 92 deletes an obsolete provision of the law that arose from the First Federal Montana Supreme Court decision -- a decision later reversed.

Section 93 repeals an ineffective wage credit that the Business Climate Subcommittee of the Council on Economic Development advised us to eliminate for precisely that reason.

Section 97 repeals another section of law related to energy deductions already qualifying as regular business expenses.

Overall what these sections do is simple:

- 1) They provide over \$6 million in annual tax reductions to 20,000 corporations by lowering the corporate tax rate to 6%.
- 2) The rate reduction is financed by \$4.25 million from closing the dividend loophole enjoyed primarily by fewer than 15 or 20 corporations and by \$2.25 million from limiting loss carryovers.
- 3) A simple alternative minimum tax is added to help finance oil tax relief measures, venture capital credits and the elimination of nuisance taxes.

The strategy of broadening the tax base and lowering rates was developed over nearly a year's discussion with the Business Climate Subcommittee of the Governor's Council of Economic Development. The Department began by proposing to that subcommittee that certain tax incentives be upgraded as a method of encouraging economic growth.

SENATE TAXATION
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That subcommittee -- comprised of business people and economists -- unanimously and forcefully rejected our first recommendations. They told us to cut the tax gimmicks. Their advice was to broaden the tax base, treat every business as equally as possible, and lower the tax rate. They told us that a low tax rate sends a stronger, more positive message to entrepreneurs than any other tax feature.

The Business Climate Subcommittee pointed in a new direction for Montana's tax policy as a means of encouraging a thriving economy. That direction is the central economic growth idea in this bill.

I want to turn now to unitary taxation. Again, the same economic growth concept is involved here. The bill retains as broad a tax base as possible and treats all corporations equally so that rates are low and competition in the marketplace is fair.

The unitary portions of the bill begin with section 40 on page 82.

Section 40 is what we call the "Halligan Amendment." It places into law the current state practice of excluding foreign parent corporations from the unitary method.

The next nine sections, 41 through 49, provide multinational corporations with the choice of filing a "water's edge" instead of a "worldwide" unitary return. These sections follow closely California's new law on this subject, a law that has removed it from the list of worldwide unitary states.

Section 41 states that a water's edge election is available and defines the subsidiaries or affiliated corporations that will be included if a corporation elects this accounting method. This is the section that will effectively remove Montana from the list of worldwide unitary states. At the same time, it defines the water's edge option in a careful way to minimize opportunities for corporations to shift income improperly beyond the water's edge.

Section 42 provides for certain requirements for a corporation to qualify for the election, including access to information and the taxation of certain dividends.

Section 43 provides that laws and regulations of other states will be used to determine questions involving activities in those states.

Section 44 circumstances under which a water's edge election may be disregarded. These circumstances involve cases where the corporation fails to provide specific information necessary to establish the proper amount of its taxable income in Montana.

SENATE TAXATION

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Section 45 describes the contract which implements the corporation's choice of a water's edge election. The election will be made for a ten year period, a proper means of preventing the switching of filing methods from year to year simply to minimize tax liabilities.

Section 46 provides penalties for failing to supply information necessary to determine the corporation's Montana taxable income.

Section 47 describes the information that is evidence in a legal proceeding involving a tax liability determined under these sections.

Section 48 provides for a domestic disclosure spreadsheet -- a document critical to administering a water's edge approach to unitary. This spreadsheet reveals where income is being earned and taxed and helps prevent income from being shifted from state to state.

Overall, Sections 42 through 48 are designed so that the flow of value between the taxable activities on the land and the non-taxable activities offshore beyond the water's edge can be traced so that income shifting does not occur.

Section 49 provides for the water's edge election fee. The fee is designed to prevent a major revenue loss or shift of the tax burden to small business. This section also provides that the fee can be reduced if the corporation invests new capital or creates new jobs in Montana.

The basic approach of this bill to unitary is to allow corporations a choice in exchange for the payment of an election fee that in turn can be reduced if the corporation helps to build Montana.

We could spend a great deal of time discussing different concepts and theories of unitary taxation, but I think one way to best understand the issue is to look at an example of two taxpayers operating in Montana. Both were profitable firms. One small Montana company paid a tax of \$820, and another multinational company, using a water's edge method, paid only \$620. Relative to the sum of the property, payroll, and sales of each company, the tax burden on the small Montana company was 50 times greater than the tax burden on the multinational company. When the tax of the multinational was recomputed using worldwide unitary, it paid a tax \$20,500. That still left the small company with a relative tax burden 2 and 1/2 times greater than the larger company. However, the difference in tax treatment was significantly narrowed by worldwide unitary. Under SB 307, the multinational firm would pay an amount of tax similar to what it would pay under worldwide unitary, so in this instance, the bill would preserve much of the basic fairness of the unitary tax system.

SENATE TAXATION

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The fact that unitary guarantees parity of taxation between all corporations can be seen in the graph I have distributed. The graph reports the results of a study comparing the relative effective tax rates for Montana corporations and larger multistate and multinational corporations. The study used a sample of 259 returns for the 1984 tax year. Although there are variations from one income level to another, the overall average effective rate of 1.5% of total income was identical for Montana corporations and for multistate and multinational groups.

If worldwide unitary works, why change? In the last three years a negative image has been attached to any state using this method. The need is to deal with this problem of image without sacrificing the fundamental fairness of the unitary system.

As it has for California, SB 307 will remove Montana from the list of worldwide unitary states. At the same time, it preserves the positive results of the unitary system.

The election fee helps prevent a loss of revenue and unfair competition for small business. Importantly it counteracts the long term, water's edge incentive of moving operations overseas into an incentive for investing in Montana.

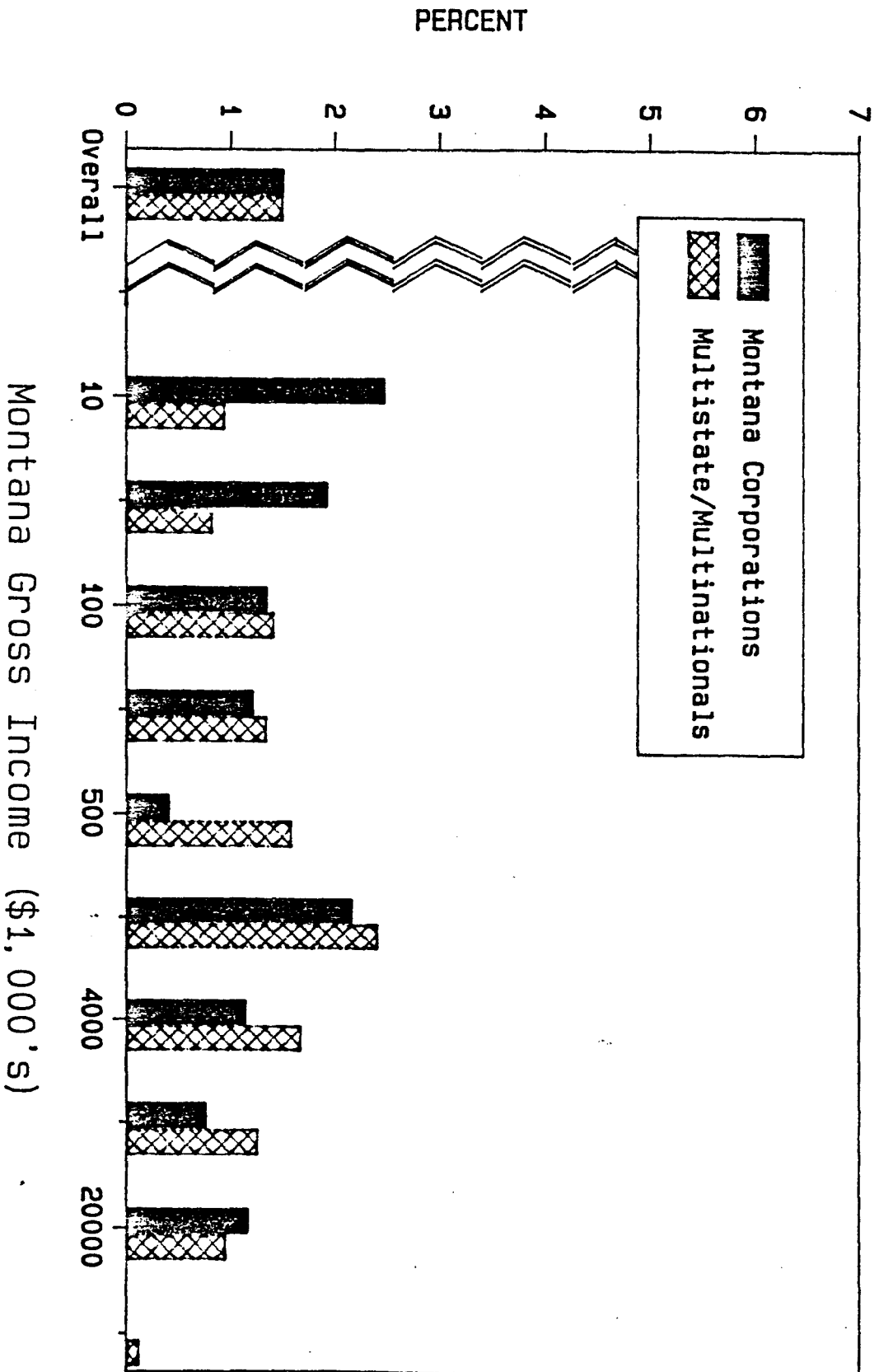
Under the terms of this proposal, Montana can change its approach to unitary while holding fast to the idea of a broad tax base, equal taxation of all businesses, and low tax rates as the best incentives for development.

SENATE TAXATION

EXHIBIT NO. 2

DATE 2-17-87

EFFECTIVE CORPORATE TAX RATES BY TYPE OF CORPORATION



SENATE TAXATION

EXHIBIT NO. 2

DATE 2-17-87

BILL NO. S. B. 307

Don Banks

Montana Retail Corp.

Multi Nat'l Retailer

Fed. }
Net }
Income } \$ 12,150

\$ 35 million

Mont. }
Property } 299,000
Payroll } 260,000 } \$ 1.3 million
Sales } 750,000

\$ 23.8 million }
\$ 6. million } \$ 85.8 million
\$ 56 million }

Tax \$ 820

- 1) \$ 620 now
- 2) 20,500

SENATE TAXATION

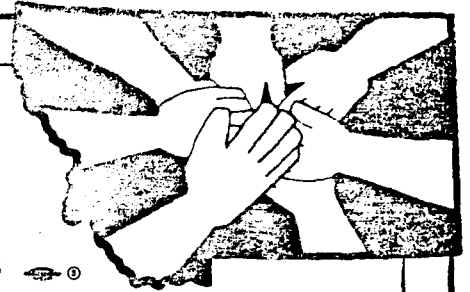
EXHIBIT NO. 3

DATE 2-17-87

BILL NO. SB-307

The Montana Alliance for Progressive Policy

P.O. Box 961 Helena, MT 59624 (406) 443-7283



SB 307: Corporate Income Tax & Unitary Taxation

Mr. Chairman and members of the committee, for the record my name is Don Reed and I'm here on behalf of the Montana Alliance for Progressive Policy in general support of the Corporate Income Tax and Unitary Taxation provisions of SB 307.

In general, we support the concept of broadening the tax base, believing that our tax system is more fair with a broad base rather than our current system which is riddled with special loopholes. This testimony will address three issues: Section 243 Dividends, Corporate Income Tax Rates, and the Unitary Taxation method.

Section 243 Dividends

The Montana Alliance for Progressive Policy supported SB 455 in the 1985 General Session to close the section 243 dividends loophole. We continue that support here. I have seen no persuasive economic analysis for why this type of dividend income should not be treated as regular corporate income. Dividends paid to individuals are taxed as income. Why should dividend income to parent corporations receive preferential treatment?

The majority of the benefit derived from the 243 loophole has gone to multi-state corporations. Approximately, \$3.5 million of the total \$5 million in 243 tax savings in FY 1985 went to multi-state corporations. In a sense, Montana has allowed these multi-state corporations to take a Montana tax advantage for investments made outside of Montana. That's not good economic development policy. This loophole should be closed whether or not it would raise the estimated \$6.8 million over the bienium.

Corporate Rates

SB 307 would sufficiently broaden the corporate income tax base to allow for a rate reduction. The governor has proposed the rate reduction in order to keep the corporate income tax reforms revenue neutral. If the legislature decides that we need additional revenue to balance the budget, this is one likely source to examine.

If the rate were not lowered from 6.75% to 6%, the additional revenue would be approximately \$9.5 million over the bienium. Whether 6% or 6.75%, the Montana corporate income tax rate is below the national average of 7.5%. Moreover, the corporate tax rate is rarely cited as an issue of concern.

SENATE TAXATION

EXHIBIT NO. 4

DATE 2-17-87

BILL NO. SB-307

Education

Senior Citizens

Women

Conservation

Unitary Taxation Method

The unitary method of calculating corporate income is as important as it is controversial. In FY 1986, the unitary method was applied to 3,700 corporations or 18% of all corporations filing Montana returns. The revenue from these corporations accounted for \$28 million or 59% of total Montana corporate tax liability before audits. Of these, only 82 corporations used "worldwide combination" and paid approximately \$6 million or 12.7% of the total.

We ^{accept} support the change to "waters edge" unitary method primarily from the standpoint that this is the de facto policy of the state. Business climate is mostly image. If "world wide combination" contributes to that image while only being applied in a relatively few situations, then made its elimination is a fair trade for the state.

Any further retreat from the unitary method is uncalled for. To go beyond SB 307 (as HB 703 contemplates) would put small businesses at a disadvantage. Multi-state corporations would have an incentive to attribute as much of their income as possible to the state with the lowest tax rate. This could well lead to an unfair competitive advantage for multi-state businesses.

Thank you for this opportunity to testify.

SENATE TAXATION

EXHIBIT NO. 4

DATE 2-17-87

BILL NO. S.B. 307

February 17, 1987

Senate Bill 307
Testimony of George D. Anderson
Montana Chamber of Commerce
Opponent - Unitary Method of Computing
Income for Corporation License Tax

There has been much discussion and argument over the past few years relative to the so-called "unitary" method of computing income for purposes of determining corporation license tax for multi-state corporations. Many times it has been referred to as the "unitary tax", however, it is not a tax in and of itself, but rather a method of computing the income of multi-jurisdictional companies. It is a method that is disliked by the taxpayers subject to it because it is patently unfair as interpreted by the Department of Revenue in Montana.

If the choice were mine, the unitary method of computing income for multi-jurisdictional companies would be repealed by the legislature and the computation would be made on a separate accounting basis. It is no secret that potential investors in Montana do not feel the present method is a fair one and, therefore, given a choice of investment in a state that uses the method and one that does not, they will choose the latter. Montana must do something daring and innovative to attract business and economic development, such as adopting tax laws that will attract rather than discourage companies from doing business in Montana.

SENATE TAXATION

EXHIBIT NO. 5

DATE 2-17-87

BILL NO. S.B. 307

Senate Bill 307 will not do the job. In fact, certain aspects of the bill are even more repulsive to multi-jurisdictional companies than is the present interpretation of the law. SB 307 enacts into law the interpretation of the present law by the Department of Revenue. This interpretation clearly discriminates against U.S. businesses in favor of non-U.S. businesses.

Let me briefly explain the principle behind the unitary method of computing income. It is felt by some that for multi-jurisdictional companies it is too difficult to compute the amount of income earned in any one state by utilizing separate accounting records for the business carried on within that state's boundaries. Therefore, a method has been devised whereby if a multi-jurisdictional company does business in a particular state, the income attributable to that state will be computed by an apportionment formula. The formula is predicated on the proposition that the factors of payroll, property investment and sales are a good determinant of the earnings of an enterprise. Therefore, the ratio that the value of those items used in the taxing jurisdiction bear to the value of those items utilized in all jurisdictions in which the enterprise operates is computed. This ratio or percentage is then applied to the net income earned in all of those jurisdictions in order to compute the income earned in the taxing jurisdiction. Montana is one of two or three states remaining that interpret the law to include the factors on a worldwide basis. Also, Montana's interpretation as to what constitutes a unitary group of businesses is much broader and much more arbitrary than most other states.

There are areas of SB 307 which in my opinion are not fair and do not address the problem we are faced with.

SENATE TAXATION

EXHIBIT NO. 5

DATE 2-17-87

SB 307 will legitimize the present practice of the Department of Revenue of not including a foreign parent's apportionment factors in the formula. Foreign jurisdictions have told us many times that they will not do business in Montana as long as there is even a threat of taxing them on a worldwide basis. SB 307 does take care of that aspect. However, in doing so, it continues to discriminate against U.S. businesses. If the tax is assessed by computing apportionment factors on a worldwide basis, U.S. businesses will still have to include all of their worldwide factors, while foreign parent corporations will not. This places American businesses at a disadvantage.

A much fairer way, for most businesses, of applying the unitary method of computing income is to apply the apportionment factors on a "waters edge" basis. This means that only the apportionment factors of the businesses U.S. operations will be utilized in the formula. SB 307 allows an election to do this, however, it charges a fee to make the election. There is no logical reason for applying the fee other than the desire to raise revenue from this source. The only logic used is that California is trying this method.

SB 307 also requires the electing company to include in its apportionment of net income the dividends that are repatriated from a foreign subsidiary. This is tantamount to including the foreign subsidiaries income in the apportionment. However, it does not allow the taxpayer to include payroll, sales or property from the foreign subsidiaries in the apportionment factors, thereby increasing the percentage of income that will be apportioned to Montana. Even California does not require the complete inclusion of foreign dividends in net income.

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California has been referred to as a state whose laws we should emulate. The statement was made yesterday that it had attracted considerable investment and, therefore, if Montana followed them, we would do likewise. I am sure we recognize the tremendous differences between California and Montana as to the attraction of investment. Companies have to invest in California because of its economic power. Companies do not have to invest in Montana to retain their economic viability, in fact, we are forced to do all in our power to attract them. We have not been exceedingly successful in doing that.

As I stated previously, Montana needs to do innovative things to attract economic development. We have tremendous resources that can be developed, but we cannot attract companies and capital to do so by constantly sending signals that we do not want you in Montana and if you come here, we are going to tax you to the maximum. Business wants to and must make a profit to survive, that is the American way. No other system has proven to be a better one to this point in time.

I urge this committee to purge from SB 307 the sections dealing with the unitary method of computing income for corporation license tax. There has been introduced in the House HB 703 which deals with allowing companies to make an election to be taxed on a waters edge basis. HB 703 is much fairer to all companies and provides a basis to attract outside companies to invest in Montana. Dr. David Birch in two appearances in Montana has urged us to reform our tax laws to give our state a more attractive business climate. SB 307 will not do that HB 703 will.

5
2-17-87
BILL NO. S.B. 30