# MINUTES

## MONTANA SENATE
## 51st LEGISLATURE - PRE-SPECIAL SESSION

## SELECT INTERIM COMMITTEE ON TAXATION

Call to Order: By Senator Del Gage, Chairman, on June 5, 1989, at 1:00 p.m.

### ROLL CALL

Members Present: Senator Gage, Senator Crippen, Senator Eck, Senator Norman, Senator Mazurek

Members Excused: Senator Harp

Members Absent: None

Staff Present: Jill Rohyans, Secretary

Announcements/Discussion:

Senator Gage explained the make up of the Select Interim Committee on Taxation and Education as per Exhibit #1.

There was discussion about the function of the select interim committees, however, until the Joint Rules Committee meets and makes a formal decision, the committees will be not be able to hold formal hearings or take action on any bills before the beginning of the special session June 19th. The tentative plan is to hold some joint taxation and education hearings before special session for review of proposed legislation.

Senator Crippen expressed concern that bills would not be prepared by the Legislative Council by the time of the meetings. He felt there was no sense in everyone coming to the meetings if there is nothing to review.

Dave Boyer, Legislative Council, explained the process of bill preparation and said they will have some of bills ready to review, others will be done, but not approved by the sponsors. The Governor's bills definitely will not be ready by that time.

It was the consensus of the committee that hearings will be held June 14 and 15 with the make up of the committees to be determined by the leadership. The Joint Rules Committee will make a formal determination as to whether these will be formal or informational hearings and whether the committees will be able to take any action on the proposed legislation.

A booklet prepared by Legislative Council Staff Researcher Jeff Martin re the gross receipts tax and value added tax was distributed to the members (Exhibit #2). There followed a general and broad ranging discussion of various options for tax reform and education funding.

ADJOURNMENT

Adjournment At: 2:38 p.m.

SENATOR DEL GAGE, Chairman

DG/jdr

INTAX605.JDR

ROLL CALL

SELECT INTERIM COMMITTEE ON TAXATION

51st LEGISLATIVE SESSION -- 1989 Date JUNE 5, 1989

| NAME | PRESENT | ABSENT | EXCUSED |
| --- | --- | --- | --- |
| Senator Gage, Chmn. | X | | |
| Senator Harp | | | X |
| Senator Crippen | X | | |
| Senator Eck | X | | |
| Senator Norman | X | | |
| Senator Mazurek | X | | |
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Each day attach to minutes.

SENATE TAXATION
EXHIBIT NO. 1
DATE 6/5/89
BILL NO. n/a

*The Big Sky Country*

# Montana State Senate

## Office of the President


**SENATOR JACK E. GALT**

SENATE DISTRICT 16
PRESIDENT

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May 10, 1989

The Honorable John Vincent
Speaker of the House
1020 South 3rd Avenue
Bozeman, MT 59715

Re: Interim Legislative Work

Dear John:

Thank you for your letter of May 1st. In an effort to put the focus where it properly should be, on the Legislative Branch, I am concurring in your request to appoint an interim select committee on Taxation and Education.

Because my powers are somewhat in the grey area during this legislative interim, I must rely on H.J.R. 14 which allows me to informally provide some leadership to the various Legislative Agencies. Further, I have conferred with our leadership including Chairman Brown of the Committee on Committees, and he has concurred with the appointments and the process. While a committee will total 12 senators, it will be divided into 2 sub-committees, one on Education Equalization and the other on Revenue. I'm suggesting that the Sub-Committee on Equalization interface either formally or informally with your Select Committee on Education Funding. Senators appointed are: Hammond Chairman, Nathe, Brown, Van Valkenburg, Regan and Pinsoneault.

President Pro-Tem Himsl has offered, and I have agreed, to designate him as the Senate's representative for the purposes of a quorum at any interim committee meeting of this sub-committee, and I'm sure you'll agree, his experience in the fiscal area should be of benefit to any such meeting.

The second sub-committee is the Committee on Taxation with the following representation: Senators Gage Chairman, Harp, Crippen, Mazurek, Eck and Norman. This Committee will work independently

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since there is no House counterpart although I'm sure they'll be interacting with several of the key members of your committee on Select Education Funding as well as your committees on Taxation and Appropriations.

I am strongly encouraging the Legislative Fiscal Analyst, the Legislative Auditor and the Legislative Council to coordinate their research efforts through these interim and select committees so that more can be accomplished in the short time we have until June 19th.

It is my expectation that several alternative approaches will be ready for presentation to the Senate, and the hearings can commence on these proposals on June 20, 1989.

Yours very truly,

Jack E. Galt

JACK E. GALT

JEG/hc

cc: Legislative Fiscal Analyst
Legislative Auditor
Legislative Council
Members of Interim

SENATE TAXATION
EXHIBIT NO. 2
DATE 6/5/89
BILL NO. N/A

# A DESCRIPTIVE OVERVIEW OF A GROSS RECEIPTS TAX AND A VALUE-ADDED TAX

May 25, 1989

Research Memorandum

Prepared by

Montana Legislative Council

Montana Legislative Council
State Capitol, Room 138
Helena, Montana 59620
(406) 444-3064

SENATE TAXATION
EXHIBIT NO. 2
DATE 6/5/89
BILL NO.

# A DESCRIPTIVE OVERVIEW OF A GROSS RECEIPTS TAX AND A VALUE-ADDED TAX

Prepared for the
Revenue Oversight Committee

By Jeff Martin
Staff Researcher

Montana Legislative Council

May 25, 1989

## INTRODUCTION

This report presents a brief overview of a gross receipts tax (or turnover tax) and a value-added tax. It is important to note that there is a distinction between a gross receipts tax that is really a sales tax and a broader-based, multistage gross receipts tax. This report describes how a multistage gross receipts tax operates in those very few states that employ the tax. Also included is an approximation of the revenue potential if such a tax were adopted in Montana.

The value-added tax is also a broad-based, multistage tax that is straightforward in its application but involves a number of theoretical and operational considerations that are beyond the scope of this report. A simplified example of the application of the tax is presented, along with a cursory discussion of Michigan's "single business tax".

## GROSS RECEIPTS TAX

As used in this section, a gross receipts tax is a tax on the privilege of engaging in business and is measured by gross income, gross receipts, or gross proceeds. The tax is imposed on the value of all goods and services sold and is a multistage tax that may be applied to every transaction occurring in the production, manufacturing, and distribution process. In those

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from the wholesaling of wheat, oats, corn and other grains are taxed at 0.011%. One of the highest tax rates (33%) is on businesses that receive and dispose of low-level radioactive waste.

The only major exempt categories are farming and the sale or rental of real estate. The exemption for real estate applies only to the sales price or rental amount and not to commissions, fees, or interest. Most commissions, depending on the contractual relationship, are subject to the tax. Employee wages and salaries, however, are exempt. There are many other special exemptions and deductions allowed under the provisions of the tax code, but they are, as a practical matter, relatively minor compared to total collections.

As an aside, West Virginia imposed a gross receipts tax similar to Washington's, but employed more differential tax rates and at generally higher levels. West Virginia abandoned its gross receipts tax in 1987.

## Indiana

Indiana is the only other state that imposes a gross receipts tax on business activity. Businesses are required to pay a 2% corporate income tax or a gross income tax, whichever is greater.

The gross income tax is imposed on the sales of goods and services and on the investment of capital, including interest, rentals, royalties, dividends, fees, and commissions. Gross receipts are taxed at one of two rates, depending on the character of the receipts. Wholesaling, advertising, accommodations, and dry cleaning or laundering are currently taxed at 0.3% (low rate); all other activities are taxed at 1.2% (high rate). The tax does not apply to individuals, partnerships, or Subchapter S corporations or regular

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corporations that could qualify for Subchapter S, all of which are subject to an adjusted gross income tax.

In 1973, Indiana began an incremental phase-out of the tax. In that year the low rate was 0.5% and the high rate was 2%. The phase-out was suspended in 1987, in part to finance an across-the-board education package.

Other States

While these states do not have a gross receipts tax as described above, Arizona, Louisiana, and Mississippi include certain nonretail transactions in their sales tax structures. Arizona applies a separate tax to public utilities, contracting, and natural resource extraction, including timber. The wholesale sale of livestock feed is also taxed, but at a much lower rate than the generally applicable rate.

Mississippi imposes a 0.125% tax on the last wholesale sale for resale at retail. In Louisiana all sales to retailers are subject to the basic sales tax rate, but retailers may take a credit for taxes paid when they file their tax returns. The tax on retailers for wholesale purchases and credit for taxes paid is essentially a value-added concept for wholesale to retail transactions. The Mississippi and Louisiana nonretail sales taxes are primarily used to ensure compliance of retailers in the administration of the sales tax.

Revenue Potential

Because the tax base under a gross receipts tax is so large, potential revenue from this tax is substantial.

Another advantage of a broad-based tax of this type is the stability of revenue collections. Revenue from the tax can be expected to grow in a steady and predictable fashion without the

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**TABLE 1**

**Potential Revenue From a 1% Gross Receipts Tax**

**(in millions of dollars)**

| | Gross Receipts | Revenue |
|---|---|---|
| Agriculture\ 1,3 | 1,392 | 13.9 |
| Mining\ 2 | 1,170 | 11.7 |
| Construction\ 3 | 1,053 | 10.5 |
| Manufacturing\ 4 | 3,000 | 30.0 |
| TCPU\ 5 | 1,488 | 14.9 |
| Wholesale Trade\ 3 | 6,500 | 65.0 |
| Retail Trade\ 3 | 5,425 | 54.2 |
| FIRE\ 5 | 2,008 | 20.0 |
| Services\ 3 | 1,803 | 18.0 |
| TOTAL | 23,839 | 238.4 |

SOURCES:

1. Montana Agricultural Statistics, 1986-1987, Montana Department of Agriculture, October 1988.
2. House Joint Resolution No. 13, 1989 Montana Legislature.
3. Sales tax data base, Montana Legislative Council, 1988.
4. 1986 Annual Survey of Manufacturers, U.S. Bureau of the Census, July 1988.
5. Survey of Current Business, "Gross State Product by Industry, 1963-86," U.S. Department of Commerce, May 1988.

Table 2 shows a simplistic, hypothetical example of a 1% value-added tax. The example is based on the wood products industries and assumes that a contract logger sells a saw log to a mill for $100. The logger's VAT is $1 based on the value of the saw log sold. The saw mill, in turn, manufactures two-by-fours and sells them to wholesaler for $200. The value added by the saw mill is $100 ($200 less the cost of the saw log) and the VAT is $1.

TABLE 2

Hypothetical 1% Value-Added Tax

| | Price to Buyer | Product | Value-Added | VAT | Gross Receipts Tax |
|---|---|---|---|---|---|
| Logger | -- | saw logs | 100 | $1 | $1 |
| Saw Mill | 100 | 2 x 4's | 100 | $1 | $2 |
| Wholesaler | 200 | 2 x 4's | 100 | $1 | $3 |
| Retailer | 300 | 2 x 4's | 200 | $2 | $5 |
| Final Price | 500 | 2 x 4's | -- | | |
| Total Value-Added Tax | | | | $5 | |
| Total Gross Receipts Tax | | | | | $11 |

The wholesaler then distributes the two-by-fours to a retailer who in turn sells them to the final consumer for $500. The retailer's value-added is $200 and the VAT is $2. The total tax collected under the VAT is exactly the same as would be collected under a retail sales tax. A gross receipts tax of 1% imposed on the same transactions (assuming no pyramiding) would yield $11, or more than twice the amount from a sales tax or value-added tax.

including corporate profits and franchise taxes, business inventory taxes, financial institutions taxes (including savings and loans), and insurance privilege fees. The major exemptions include agricultural production and the first $40,000 of business or gross receipts. Retailers engaged in selling food are also allowed a deduction for a certain proportion of gross receipts attributable to food sales.

After a phase-in period from 1975 to 1977, tax collections in Michigan have been remarkably stable and have exhibited a long-term growth pattern much in line with growth in total personal income in the state. As a result of the growth and stability, the initial tax rate of 2.35% has never changed.

## CONCLUSION

Both the gross receipts tax and value added-tax are broad-based taxes that can generate a significant amount of revenue at fairly low rates. The application of a gross receipts tax is straightforward but imposes a number of economic distortions that limit its desirability as a replacement tax.

The value-added tax is also a straightforward concept, but the application of the tax would first require a significant change in the perception of the way business activity is taxed. And although the value-added tax is essentially a tax on business, many of the same arguments used in support of or in opposition to a sales tax would be brought to bear (e.g., improved business climate versus the regressivity of the tax).

# REFERENCES

Advisory Commission on Intergovernmental Relations, The Michigan Single Business Tax: A Different Approach to State Business Taxation, Report M-114, (Washington, D.C., March 1978).

Cline, Robert J., "Should States Adopt a Value-Added Tax?", in The Unfinished Agenda for State Tax Reform, ed. Steven D. Gold (Denver: National Conference of State Legislatures, 1986).

Due, John F., and John L. Mikesell, Sales Taxation: State and Local Structure, (Baltimore: The Johns Hopkins University Press, 1983).

Wieferman, John, "The Value Added Tax", in Rethinking Texas Taxes, Final Report of the Select Committee on Tax Equity, Volume 2, ed. Billy C. Hamilton (Austin: February 1989).

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SELECT INTERIM COMMITTEE ON TAXATION

DATE June 5, 1989

VISITORS' REGISTER

| NAME | REPRESENTING | BILL # | Check One Support | Oppo |
|---|---|---|---|---|
| Doug Abelin | Montana Oil & Gas | | | |
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(Please leave prepared statement with Secretary)