MINUTES

MONTANA SENATE

51ST LEGISLATURE - SPECIAL SESSION

COMMITTEE ON TAXATION

Call to Order: By Chairman Brown, On June 28, 1989, at 9:00 a.m.

ROLL CALL

Members Present: Senator Bob Brown, Chairman, Senator Hager, Senator Bishop, Senator Crippen, Senator Eck, Senator Gage, Senator Halligan, Senator Harp, Senator Mazurek, Senator Norman, Senator Severson, and Senator Walker.

Members Excused: None.

Members Absent: None

Staff Present: Jill Rohyans, Committee Secretary
Greg Petesch, Legislative Council

Announcements/Discussions: None

HEARING ON SENATE JOINT RESOLUTION 1

Presentation and Opening Statement by Sponsor:

Senator Gage, District 5, sponsor, stated Senate Joint Resolution 1 deals with county consolidation and tax reform. Taxpayers continue to say money can be saved if counties, schools, university systems are consolidated. The resolution asks for a study, and specifies that all tax roll property be taxed at 100% of market value. This process eliminates all percentage taxation discrepancies which currently vary from 75% to 4%. A degree of equalization can be realized by placing everything on the tax rolls at market value. The mills drop because of the taxable value increases. County reorganization is also addressed, as are county job positions. Regional jails may also be included, but the process will require a state mandate. Senator Gage stressed it is important to study cost saving issues before legislation is enacted. School districts will be studied for redistricting, possibly on county wide basis as being more cost effective. University systems will also be studied for feasible cost cutting measures. Senator Gage said it is necessary to look at the entire picture as each change proposed change will impact another area. Total tax reform is the only sure way to be fair and equitable.

List of Testifying Proponents and What Group They Represent:

None

List of Testifying Opponents and What Group They Represent:

Gordon Morris, Montana Association of Counties

Testimony:

Gordon Morris, representing the Montana Association of Counties, presented the committee with a copy of a book, Montana Counties on the Move (Exhibit #1). The 1974 addition will soon be replaced by the 1988 addition. He noted nothing has changed, therefore, the consolidation section is very enlightening. A resolution opposing county reorganization and passed by the Association of Counties and county commissioners, was also distributed to the committee members (Exhibit #2).

Mr. Morris proposed amending the bill on line 15 by striking "county governments", line 1, page 2, strike "all counties", and striking line 14, section 2, through line 22.

County consolidation is not the answer, according to Morris. It is not unusual for a state the size of Montana to have 56 counties. South Dakota has 66 counties. The problem is lack of population. The Constitution provides for periodic ten year reviews of local government. In 1986, the first review process under the new constitution ended without any changes being made. Montana law provides for consolidation and local government restructuring. The question leaves the answer in the hands of local constituents. Currently, if people in Jefferson County want to consolidate with Lewis and Clark County, they can do so. A majority of voters in the respective counties must approve. County consolidation is similar to the proposition of municipal annexation. If counties are consolidated, the counties are actually being annexed. Rural counties will be annexed into urban counties. All county roads will have to be maintained, whether Montana has one county or 56 counties.

Questions From Committee Members:

Senator Eck felt the Revenue Oversight Committee should be charged with conducting the study. The current statutes and the determination of local government bonding capacities should also be addressed.

Senator Gage stated piecemeal attempts to address state problems are not satisfactory. State organization, tax structure, schools, and other problems must also be addressed.

Senator Eck stated the task of solving the tax reform problem will require a full time commitment from staff, legislators, and voters. Interim committees do not have the capacity, staff, or funds to address the issues properly.

Closing by the Sponsor:

Senator Gage stated the subject is within the call. Senator Gage challenged the counties to show that county consolidation provides less equalization than what is currently called for in the resolution. The resolution asks the state to look at cost cutting measures. Senator Gage urged passage of SJR 1.

HEARING ON SENATE BILL 25

Presentation and Opening Statement by Sponsor:

Senator Gage, District 5, Sponsor, stated the bill is a result of personal efforts started in 1972. The bill eliminates the net proceeds tax and replaces the tax with a local government severance tax. As a result, the natural resource industry will be held somewhat tax neutral. One advantage of SB 25 is the state gets out from under the administration and complexity of the net proceeds tax.

Senate Bill 25 effects all counties. This bill is an attempt to go to a state wide proceeds rate in the form of a local government severance tax, with a mechanism to redistribute those funds back to the counties and school districts on a tax neutral basis, based on 1989 figures. It also provides for those distributions to a school district will be made on the basis of the millage in place in 1989. The counties are required to take non-mill generated revenues and distribute on the percentage of millage, however, the schools are allowed to raise mills. Therefore, counties are losing part of the non-mill generated revenue. The fact escalates when the mill generated revenue is put into non-mill generated revenue. The bill is an attempt to keep the counties from losing revenue to the school districts and foundation program. The bill provides only one half of the local government severance tax rates on stripper wells and is patterned so all the stripper production will be taxed at 50%. A provision to reflect loss of tax base into the taxable values, as far as county classification and bonding purposes are concerned, is included. The bill is included in SB 26, however, if SB 26 is defeated, this concept (SB 25) will stay intact. The bill helps solve the equalization problem because the tax revenues are no longer subject to the additional voted levies which are in place at the time the bill takes effect. Those levies will be automatically reflected in the 8.4 rate, an equalization mechanism.

The bill will not be tax neutral for individual operators. Some operators are now paying less than 8.4%, and they will get a tax raise. If the operator does not pay net proceeds tax continually, he will quickly be out of business. There are deductions and costs not deductible for net proceeds calculations. Another possibility is a discrepancy on the net proceeds tax return which is not justified, or if operations are continued on a small loss basis in hopes prices will rise. Tax write-offs are not justified, either.

<u>List of Testifying Proponents and What Group They Represent:</u>

Janelle Fallan, Montana Petroleum Association
Ken Nortdvedt, Director, Department of Revenue
Jerome Anderson, Shell Western Exploration and Production, Inc.

Doug Abelin, Montana Oil and Gas
Willie Ductfield, Fallan County Commissioner, Director, Montana Oil and Gas
Senator Dennis Nathe, District 10

Testimony:

Janelle Fallan, Director, Montana Petroleum Association, stated support for SB 25. The net proceeds tax is one of the most complex taxes in the nation. Two years ago the Montana Petroleum Association and Montana Department of Revenue attempted to rewrite net proceeds tax rules. The deduction

section was cleaned up at that time which is the section slated to be wiped out if SB 25 passes. Senate Bill 25 is a major step towards Montana petroleum industry tax stability. Presently, dozens of audits, involving millions of dollars, are being conducted at the state level. Senate Bill 25 takes away deductibles. Small producers consider deductibles important, but are willing to give up the deductions.

Fallan reported the reason SB 25 is coming before the session is because of the mill levies and school equalization bill. The problem with mandatory mill increases is a disproportionate impact on the oil and gas industry. Class one property is the only class taxed at 100% value. This has traditionally brought up the value per mill. The high mandatory mill punished the oil producer, who had already paid a large share of tax in the district. The question of revenue neutrality is slightly above revenue neutral state wide. The Association has problems with rates. The rate on gas can be as much as two to three percentage points too high, according to the producer's standpoint. The current method rewards inefficiency. Senate Bill 25 maintains the distinction between old and new production.

Ken Nordtvedt, Director, Department of Revenue, stated the tax on resource production is one of the most complex and litigated taxes in the state. The proceeds tax statute is ambiguous and is in need of simplification. The flat tax creates stability. It freezes the effective percentage rate, so if the future property tax mill is raised or lowered, the tax stays the same because it does not follow the mills. Senate Bill 25 is a positive step and will permit the Department of Revenue to streamline the natural resource tax division. The allocation remains complex. Senate Bill 25 is an allocation program. It is as fair as it possibly can be in regards to tax and jurisdiction.

Jerome Anderson, Shell Western Exploration and Production, Incorporated, stated Shell produces approximately 40% of Montana's oil. Shell is a principal loser in regards to SB 25, yet the company supports the legislation. Considering Fallan County, where 80% of the production is located, the flat tax was raised to a percentage of net proceeds tax for gross. The raise was from 6.39% to the proposed 8.4% rate, a 37% tax increase.

Doug Abelin, Montana Oil and Gas, expressed support for SB 25.

Willie Ductfield, Fallan County Commissioner and Director for the Montana Oil and Gas, stated concern about the state collecting funds and distributing funds back to the counties. Another concern regards fund distribution. The effective Fallan County tax rate is 6.3% and will be increased 37% to 8.4%. There is no provision, if the valuation is dropped to 20, 15 or 10 million, that Fallan County will come up to 8.4%. It is not fair that Fallan County is stuck at 6.4%. The intent of the bill is to equalize school funding, not equalize county governments.

Senator Dennis Nathe, District 10, stated SB 25 is a good concept, according to the industry. On behalf of the Sheridan County Commissioners, Senator Nathe raised the local government severance tax issue. Sheridan county had a bad experience. In 1981, when the taxable evaluation of vehicles was cut, vehicle owners were given a flat fee, and block grants were given back. Sheridan County came up short, as did other counties. Sheridan County Commissioners want to collect this tax, want to withhold Sheridan County's portion to run the county, and send the school's portion in. The concern is having the funds sitting in Helena, as the state faces a money shortage, and seeing the possibility of the money inadvertently used to solve school problems. The commissioners suggest the tax be collected at the county level and monitored on the local level. The county commissioners are interested and are watching what companies are producing. The commissioners know when something is abnormal and can spot problems quickly. Senator Nathe suggested modification to allow local government participation in tax collection.

Questions From the Committee Members:

Senator Eck asked if the distribution is based on 1989 allocations, collected from net proceeds.

Senator Gage stated distribution is based on the 1988 net proceeds and the 1989 millage.

Senator Eck asked if the counties could take advantage of the net proceeds if the county wanted to build a jail in 1991. If the county did not have mills levied in 1989 against the net proceeds tax, would the county be able to levy the jail against the remaining taxpayers?

Senator Gage said the current amount is part of the 8.4 gross, based on the millage. It makes no difference whether the millage is voted, mandatory, or permissive.

Senator Eck asked if the foundation program was set at substantially less than what the school district ordinarily spends, would the county have to have a number of additional levies voted in and would the amount would be included.

Senator Gage said no. He further stated, without looking at SB 25 or any increases, the cost is currently zero. If the mills drop, the county also continues to receive the same current revenue. The counties do not get a decrease when the millage is dropped.

Closing by Sponsor:

Senator Gage stated future mills do not generate revenue, nor does mill reduction reduce oil company revenue. Senate Bill 25 converts previous tax dollars to a unit of production of value based on millage. The school districts will get that amount in the future per barrel produced in the school district.

Senate Bill 25 considers price increases. If more tax is collected, the districts will also receive a percentage of the price escalation. Senate Bill 25 spreads delinquency statewide. When the states collects the anticipated tax, the state will distribute in November and May. In order to meet state delinquency, the per barrel adjustments will be made on gas values by the amount of collections to the amount of liability. The interest income the state receives from investments of the funds between collection and distribution will be included in the distributions. It will also include any interest and penalties the state collects. If 97% is collected, the counties will get 97% of the tax unit values. If there is a three percent delinquency from the first half year's collections, the second half collection will be 103% of liabilities. The delinquencies are a state wide spread. Senate Bill 25 takes collection out of county government, and puts it at a state level.

The counties will get the same revenue under SB 25. as under the net proceeds tax. The bill is tax neutral to the extent of extractive taxes. The taxpayers will still pay increases on personal property taxes. If the mills escalate on personal property, the taxpayers will take the same hit on personal property as everyone else. When people want to bring business into a state, their biggest concern is tax structure stability. There is a one year delay in the distribution of funds collected, as there is a one year delay in net proceeds tax. The 1988 taxes are assessed from 1989, and the collections are made in November 1989 and May of 1990.

HEARING ON SENATE BILL 27

Presentation and Opening Statement by Sponsor:

Senator Paul Rapp-Svrcek, District 26, sponsor, stated the unfunded liability is a ball and chain around Montana's neck. Senate Bill 27 places a half percent tax per one hundred dollar value on public traded stocks and bonds. All the proceeds from the tax will go into the unfunded liability. The outcome would be a lowering of rates. The first $10,000 value of public traded stocks and bonds is exempted for people who retire on small investments. The stocks and bonds are exempted for Montana held corporations and corporations doing business in and outside Montana. The tax will be prorated. The bill runs concurrently with the employer and employee tax. Presently, the tax terminates on June 30, 1991, and if the employer and employee taxes were extended, it would be his intent to extend SB 27's tax as well. The bill could collect approximately $12 to $16 million, but could possibly collect as much as $65 million per year. High technology computers will aid in the implementation of the reporting requirement. Montana must make policy decisions to subsidize the Workers Compensation System, at least until the unfunded liability is funded. Every revenue source must be looked at to provide unfunded liability funding.

List of Testifying Proponents and the Groups They Represent:

Representative Mark O'Keefe, House District 45
Don Judge, Montana AFL-CIO
Ann Prunowski, Montana Alliance for Progressive Policy

Testimony:

Representative O'Keefe, House District 45, expressed support for SB 26. Intangibles are valuable and can be sold. Approximate 10 to 43 states tax intangibles. Florida raises $367 million a year from intangibles for its general fund. Kentucky raises $55 million at approximately one fifth the rate in the Montana bill. This is a taxation fairness and equity question. The bill tries to make the codes similar to income producing property statutes. The money which is used to buy property is taxed, and the property is taxed once the property is owned. The owner also pays taxes on the income produced. The exception for instate corporations is a drawing card for out of state investments. The bill ties into the Workers Compensation problem. It is business oriented money that is out there now. One percent of Montanans hold 60% of the stocks that would be taxed under the bill. The bill assesses the tax based on the ability to pay.

Don Judge, Montana AFL-CIO, stated the Workers Compensation system had projected an outstanding fund deficit when the Legislature adjourned in 1987. The amount was approximately $150 million. Between the regular session and the special session, a audit was conducted by a San Francisco actuary. The determination was the fund was running at a deficit of approximately $215 million. There is disparity between the Workers Compensation position following the actuarial study. The legislative auditor believes the unfunded liability amount may not be as high. The Workers Compensation Division's statutes mandates an actuarially sound program. In order to bring more money in than is going out, the Division must raise rates on Montana employers an average of 22%. The rate increase goes into effect July 1, 1989. There may not be a need for the legislation, according to Judge. There should be an exemption until an independent audit can be conducted. There are approximately $29 million in cash investments for the Workers Compensation Fund, through the Board of Investments. It is projected the Division will not go broke if there are no rate increases scheduled July, 1989. The division will cut down the cash balance, and will draw less money from investments.

The rising premium increase should be addressed. The Montana Constitution, Article 2, Section 16 provides for workers to withhold the right to sue their employers, provided the employer provides Workers Compensation protection. The AFL-CIO's understanding is the employer will provide coverage. However, if workers begin to pay for a portion of that cost, then the employer no longer contributes. This leaves open a law suit challenge on the Constitution, which could result in an injunction on withholding the increases on the rates for years, while the dispute is settled.

We need to subsidize the system and provide, at least a one time, temporary flow of capital into the system. Idaho subsidizes the Workers Compensation Division by charging higher rates for low risk industries, so they can hold down the top rates for high risk industries. The fund should be solvent and self sufficient. The legislation broadens the tax base, recaptures income that was in Montana previous to 1983, and is progressive tax reform. The Montana AFL-CIO supports SB 27, whether it is used for Workers Compensation or not.

Ann Prunowski, Montana Alliance for Progressive Policy, stated SB 27 is an important part of property tax reform. Over the years, the tax base rationale has come primarily from income producing property. Senate Bill 27 is seen as an attempt to establish a more equitable tax system, which encourages Montana investments. The tax is based on the ability to pay.

<u>List of Testifying Opponents and the Group They Represent:</u>

Dennis Burr, Montana Taxpayers Association
Jim Tutweiler, Montana Chamber of Commerce
Steve Bender, Deputy Director, Department of Revenue

<u>Testimony:</u>

Dennis Burr, Montana Taxpayers Association, stated the reason why Montana taxed solvent credits prior to 1973 is because the Constitution prohibited the Legislature from exempting any property that was not listed as exempt in the Constitution. There was a tacit understanding between the legislature and county assessors, at the time, that solvent credit would be ignored and placed in the lowest classification groups. The solvént credit class applied to stocks and bonds, to the amount of money an individual or corporation had in a bank account on the first Monday in March as an assessment date, and to other applications. Laws also prohibited banks from letting the Department of Revenue know the amounts in bank accounts. The entire tax system was fairly unworkable. Senate Bill 27 cancels the July 1st effective date. The January 1 date, or any other date, is the basis for objection, in regards to the ability to collect tax. At a rate of five percent, it would benefit the individual to sell whatever stocks or bonds he or she had on the 29th of December, the day before the effective January 1 date, and reinvest a few days later. The small family investor may not find this action beneficial, but most money invested in the stock exchange is held by institutional investors. In this case, there would be sufficient reason to change the holdings on the particular date to avoid the tax. Equal protection problems could arise by allowing the Montana investor exemptions. Mr. Burr concluded by saying the bill is overall unworkable and taxes the small investor instead of the large institutional investor.

Jim Tutweiler, Montana Chamber of Commerce, agreed with Mr. Burr's testimony. He said a selective tax is not the way to address the Workers Compensation problem. He said the bill could ultimately result in triple taxation for some and certainly poses a possible Constitutional question.

Steve Bender, Deputy Director, Department of Revenue, said he opposes the bill for the reasons presented by Mr. Burr. He said intangible taxes are on their way out nationwide. He said this type of tax also puts a terrific administrative burden on the Department.

Closing by Sponsor:

Senator Rapp-Svrcek closed by saying the business community wants to do something about the economy and the unfunded liability and this bill is a vehicle for change. He said the business community can make a larger contribution through this bill than the individual and the problems Mr. Burr and Mr. Bender worry about in this respect do not exist. He said .5 of 1% is a small amount and good compliance would be easy to obtain with relatively easy administration. He urged the committee to support the legislation.

ADJOURNMENT

Adjournment At: 11:00 a.m.

Bob Brown
SENATOR BOB BROWN, CHAIRMAN

BB:jdr
TAX-6-28:mfjdr

ROLL CALL

TAXATION COMMITTEE

51st LEGISLATIVE SESSION -- 1989 Date 6/28/89

SPECIAL

NAME	PRESENT	ABSENT	EXCUSED
SENATOR BROWN	X		
SENATOR BISHOP	X		
SENATOR CRIPPEN	X	late	
SENATOR ECK	X		
SENATOR GAGE	X		
SENATOR HAGER	X		
SENATOR HALLIGAN	X		
SENATOR HARP	X		
SENATOR MAZUREK	X		
SENATOR NORMAN	X		
SENATOR SEVERSON	X		
SENATOR WALKER	X		

Each day attach to minutes.

SENATE TAXATION
EXHIBIT NO. 1
DATE 6/28/89 a.m.
BILL NO. SJR 1

MONTANA COUNTIES ON THE MOVE...

MONTANA ASSOCIATION OF COUNTIES

SENATE TAXATION
EXHIBIT NO. 2
DATE 6/28/89 a.m.
BILL NO. SJR1

RESOLUTION 87- 8

COUNTY CONSOLIDATION

WHEREAS, the 1987 Legislature considered County Consolidation; and

WHEREAS, local voters enjoy the rights of petition and initiative as a means to achieve county reorganization and consolidation; and

WHEREAS, the impetus for county reorganization and consolidation should be from the local level.

NOW THEREFORE BE IT RESOLVED that the Montana Association of Counties oppose any legislative mandate for county reorganization and consolidation, which does not call for submission of the question to the electorate of the affected counties, as set forth in the Montana Codes Annotated.

SPONSORED BY: DISTRICTS 1, 2, & 3

APPROVED: ANNUAL CONVENTION, JUNE 9, 1987

REAFFIRMED: ANNUAL CONVENTION, JUNE 15, 1988

REAFFIRMED: ANNUAL CONVENTION, JUNE 21, 1989

WITNESS STATEMENT

SB 27

NAME: Don Judge DATE: 6-28-89 a.m.

ADDRESS: PO Box 1176 Helena, MT 59624

PHONE: (406) 442-1708

REPRESENTING WHOM? Montana State AFL-CIO

APPEARING ON WHICH PROPOSAL: Senate Bill 27

DO YOU: SUPPORT? X AMEND? ____ OPPOSE? ____

COMMENTS: (1) unsure of need for workers' comp subsidy, but, if needed, this is a preferable option to others being considered

(2) presents an opportunity to address two important concerns regarding economic development --- addressing the rate premiums for Montana employers
--- providing progressive tax reform

(3) No one can say for sure that our WC system is "on the rocks" but what we do know for sure is that the WC Division is going to raise rates on MT employers --- if you want to help hold these rates down, SB 27 is one good option --- other States surrounding MT do subsidize employer rates - either through establishing minimum rate structures regardless of actual ~~[illegible]~~ risk of employment, like Idaho --- or by ~~[illegible]~~ subsidizing with general fund revenue - Wyoming has both. It is your option, we would support passage of SB 27 should you choose to subsidize our WC System

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

DATE 6/28/89 a.m.

COMMITTEE ON Taxation

VISITORS' REGISTER

NAME	REPRESENTING	BILL #	Check One	
			Support	Oppo
Gordon Morris	MACo	SJR 1		✓
" "	"	SB 25		
Janelle Fallan	MPA	25	✓	
Don Judge	MT STATE AFL-CIO	SB 27	X	
[illegible]	MAPP	SB 27	X	
Doug [illegible]	Montana Oil & Gas	SB [illegible]	✓	

(Please leave prepared statement with Secretary)