

MINUTES

MONTANA HOUSE OF REPRESENTATIVES 51st LEGISLATURE - 1st SPECIAL SESSION

COMMITTEE ON TAXATION

Call to Order: By Chairman Dan Harrington, on June 29, 1989, at
2:00 p.m.

ROLL CALL

Members Present: 21

Members Excused: None

Members Absent: Representative Ellison

Staff Present: Lee Heiman, Legislative Council
Donna Grace, Committee Secretary

Announcements/Discussion: None

HEARING ON SENATE BILL 6

A BILL FOR AN ACT ENTITLED: "AN ACT ALLOWING APPLICATION OF AN INFLATION FACTOR TO ~~CAPITAL GAINS OR LOSSES~~ THE COST BASIS OF CAPITAL ASSETS FOR PURPOSES OF TAXATION; AMENDING SECTIONS 15-30-111, 15-30-136, 15-31-114, AND 15-31-304, MCA; AND PROVIDING AN APPLICABILITY DATE."

Presentation and Opening Statement by Sponsor:

Senator Crippen, House District 45, Billings and chief sponsor of Senate Bill 6 explained the bill by saying Senate Bill 6 is a bill introduced at the request of the Governor, and the intention of the bill is to remove from taxation the element of gains that are solely due to inflation. Inflation, especially when rampant has a tendency to erode true gain when a capital asset is sold. He said this bill would set up an inflation factor which would divide the consumer price index for June of the taxable year 1988 by consumer price index for the year in which the property was acquired, or if after '88 then the CPI when it was acquired. He said in 1981 they did some indexing which attempted to address the problem of inflation. He said it did keep some money in circulation that otherwise would have been lost because of inflation. He said this bill would attempt to do that in the area of capital gains, and it does not create a separate tax rate.

Senator Crippen passed out a memo from the Department of Revenue which is attached as EXHIBIT 1 and said on the third page, example 2, he has an example of what how this would work. He also walked the committee through example 4 on

the following page. He said all this bill does is reduce the impact of inflation and is particularly important in Montana where a sale often represents the only asset of the taxpayer such as his land or his home.

Senator Crippen said Director Nordtvedt appeared at the Senate Taxation committee hearing and testified that this particular type of approach is evidently under consideration at the federal level. He said that they may consider this type of indexing rather than a preferential tax rate treatment.

Testifying Proponents and Who They Represent:

None

Proponent Testimony:

None

Testifying Opponents and Who They Represent:

None

Opponent Testimony:

None

Questions From Committee Members:

Representative Driscoll commented if the federal government changes their law Montana automatically would have to go along anyway. Senator Crippen says yes.

There was some discussion on the state changing their laws when the federal government did, and Senator Crippen said they did change some in 1987 when we deviated from the federal law. He said there were a lot of farms and ranches that had been sold prior to that time on an installment basis, then the federal law accelerated it, but we did change it in the state.

Representative Elliott said he had no objection to this method being applied to personal assets, but as far as investment property such as stocks and bonds were concerned, inflation is one of the factors to be taken into account in investments and that is a part of the risk in investment. He said he would object to investment assets being treated in this manner. He asked if there was any objection to an amendment to take those out. Senator Crippen said first they would have to define what an investment asset is. He said a capital asset in the form of an intangible would make a good point. A capital asset such as a home or ranch is still a capital asset and if a distinction can be made he would have no objection.

Representative Stickney asked who would primarily benefit from this bill, and Senator Crippen answered it would be anyone who has a capital asset and is going to sell it. Representative Stickney asked if this would reduce the taxes coming to the state and Senator Crippen answered exactly, because it is indexing.

Representative Gilbert gave an example of a couple acquired land years ago and didn't have a retirement program, and when they decided to retire the proceeds from the ranch became their retirement. The way our capital gains are now we are punishing them, but under this bill we would be giving them a little more, thus adding to their retirement because it would cut down their tax burden by using the inflation factor. He said in rural Montana all a lot of agricultural people have is the ranch, and when they get ready to retire, that is their retirement. Senator Crippen agreed.

Representative Koehnke asked if there was a fiscal note. Senator Crippen said there is a fiscal note. He said this was in SB 463 as a part of that bill in the session that had a 1980 date to peg the CPI, and this changes it to June of 1988 so it makes a substantial difference, the fiscal note for FY '90 is zero, for FY '91 it is \$250,000. He said it is difficult to project how it will affect it down the line. They have made assumptions that some of these capital assets will be held as long as 30 years and if that is the case you will be looking at a lot of money, about \$8 million in 30 years and if the federal comes in and changes it that will affect it as well.

Representative Hoffman said the way this is written it only applies to assets that are purchased after December 31, 1989 and asked if that is correct. Senator Crippen said the taxable year is after 1989 but affects land that has been held prior to that. Rep. Hoffman asked if it would be prior to 1935 and Senator Crippen said yes.

Representative Kadas said he thought this was a bad bill, we have spent more money today than we have and now we are giving the rest of it away.

Representative Elliott said he would like to put an amendment on. He said he would like that amendment to read "this act will apply to anything that is subject to real property tax." There was some discussion as to personal property, real property, personal and commercial, etc. and Representative Elliott said property in any form. He said he just wanted stocks and bonds out of the bill.

Representative Stang said there are a number of people out there who have their small businesses, ranches or farms incorporated and when they sell them they also sell their stock and they pay a pretty healthy gain even though their

stock is their asset.

Closing by Sponsor:

None

DISPOSITION OF SENATE BILL 6

Motion: Representative Schye said it was late and there was no one present to testify on the bill so he would make a motion to table Senate Bill 6.

Discussion: None

Amendments, Discussion, and Votes: None

Recommendation and Vote: Motion failed with 7 members voting yes, 15 members voting no, roll call vote.

Chairman Harrington said that discussion on the amendment would continue.

Representative Good said since the amendment was still being discussed she felt they had not had enough time to think of this. However, if it is a good enough idea, she suggested they put it out on the floor although she thought that might be premature.

Representative Patterson said probably the biggest problem with this bill is Representative Elliott's discussion about the stocks and bonds. If you put an amendment in there to also take care of Subsection (s) corporations, it will take care of most of the people that have incorporated over in your area, whether they are K Mart or Burlington Northern.

Representative Giacometto said he thought this would address everyone and also home owners. If a person sells their house and retires on that, this would also exempt them. He said this also goes in on retirement. We are talking about the \$12,000 exemption. This would apply to people in business and people who are going to sell their house.

Representative Schye asked what this would cost the state and Chairman Harrington said the first year was zero and the second was \$250,000, but the statement was made by the sponsor that it could go to \$8 million.

The question was called for a vote on the amendment when a substitute motion was made.

Motion: A substitute motion was made by Representative Elliott to table Senate Bill 6.

Recommendation and Vote: The Chairman called for a voice vote, hands were counted and the chairman announced the motion had

carried and the bill was tabled.

ADJOURNMENT

Adjournment At: 2:30 p.m.



REP. DAN HARRINGTON, Chairman

DH/dg

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DAILY ROLL CALL

HOUSE TAXATION COMMITTEE

DATE:

June 29, 1989

NAME	PRESENT	ABSENT	EXCUSED
<u>Dan Harrington. Chairman</u>	✓		
<u>Bob Ream, V. Chairman</u>	✓		
<u>Ben Cohen</u>	✓		
<u>Jerry Driscoll</u>	✓		
<u>Jim Elliott</u>	✓		
<u>Orval Ellison</u>			
<u>Leo Giacometto</u>	✓		
<u>Bob Gilbert</u>	✓		
<u>Susan Good</u>	✓		
<u>Ed Grady</u>	✓		
<u>Marian Hanson</u>	✓		
<u>Robert Hoffman</u>	✓		
<u>Mike Kadas</u>	✓		
<u>Francis Koehnke</u>	✓		
<u>Mark O'Keefe</u>	Excused		
<u>John Patterson</u>	✓		
<u>Bob Raney</u>	✓		
<u>Dennis Rehberg</u>	✓		
<u>Ted Schye</u>	✓		
<u>Barry Stang</u>	✓		
<u>Jessica Stickney</u>	✓		
<u>Chuck Swysgood</u>	✓		

DEPARTMENT OF REVENUE

STAN STEPHENS, GOVERNOR

MITCHELL BUILDING

STATE OF MONTANA

HELENA, MONTANA 59620

MEMORANDUM

EXHIBIT 1
DATE June 29, 1989
HB SB 6

To: Senator Bruce Crippen

From: Steve Bender, Acting Deputy Director
Department of Revenue

Re: Explanation of Amendments to SB 6

Date: June 22, 1989

Attached to this memo please find:

- * Proposed amendments to SB 6 providing corrections, clarifying the application of the bill to assets sold and assets retained, and extending this treatment to taxpayers subject to the Corporate License Tax.
- * Examples of how SB 6, as amended, would work

As we have discussed this bill is intended to remove from taxation the element of " gains " attributable solely to inflation. This is accomplished by indexing the cost basis of an asset. Under this bill the adjustment will occur whether the business asset is sold or retained past its "useful life".

In the former instance, the bill provides for the calculation of an adjusted cost basis to be used in arriving at the true gain subject to Montana taxation. The Montana adjusted capital gain will be compared to the federal gain reported to calculate the adjustment necessary to remove the effects of inflation. Since the full amount of the gain will have been included in federal AGI, the adjustment will be an additional deduction for Montana purposes assuming the asset was held over an inflationary period.

Ex #1 PS2
6-29-89
506

Senator Crippen
June 22, 1989
Page 2.

In the case of an asset retained past its useful life, ie. fully depreciated for federal purposes, the bill provides for a calculation of an additional depreciation deduction to mitigate the effects of inflation. This is accomplished by providing a one time, additional, deprecation deduction without radically departing from federal depreciation methods.

Briefly, the additional depreciation deduction is equal to the amount the cost basis of the asset, adjusted by the inflation factor, exceeds the accumulated federal depreciation specific to that asset. The deduction is granted in the year following the final year of federal depreciation. This provision will address the disparity created in inflationary periods by limiting the write off of business investments in depreciable assets to historical dollars.

If we can provide anything further, please advise.

Ex. #1 p.3
6-29-89
SB 6

SB 6 AS AMENDED EXAMPLES
CAPITAL GAIN AND DEPRECIATION INDEXING

ASSUMPTIONS

1. There is an inflation factor of 4% per year
2. The inflation factor is compounded each year
3. Indexing starts in 1988

EXAMPLE #1

Item:	Stock	Sales Price:	\$15,000
Bought:	Jan. 1990	Cost:	10,000
Sold:	Feb. 1991		

Gain Under:	<u>Present Law</u>	<u>SB #6</u>
	\$15,000	\$15,000
	(10,000)	10,000 x 1.04 = 10,400
	<u>5,000</u>	<u>4,600</u>

\$400 less gain would be reported under SB 6 because of the indexing of the inflation factor.

EXAMPLE #2

Item:	Land	Sales Price:	\$60,000
Bought:	Jan. 1990	Cost:	30,000
Sold:	Jan. 1994		

Gain Under:	<u>Present Law</u>	<u>SB #6</u>
	\$60,000	\$60,000
	(30,000)	30,000 x 1.17 = 35,100
	<u>30,000</u>	<u>24,900</u>

\$5,100 less gain would be reported under SB 6 because of the indexing of the inflation factor.

EX. #1 PS 4
6-29-88
SB 6

When depreciation is involved there is a two step process. First the adjusted basis has to be calculated. Then the gain is found by subtracting the adjusted basis from the sales price.

EXAMPLE #3

Item:	Depreciable Machinery	Sales Price:	\$120,000
Bought:	Jan. 1988	Cost:	100,000
Sold:	Jan. 1993	Depreciation	
Inflation		taken	50,000
factor:	1.22		

Gain Under:	<u>Present Law</u>	<u>SB #6</u>
<u>Step 1:</u>		
Cost	100,000	$100,000 \times 1.22 = 122,000$
Depreciation	(50,000)	(50,000)
Adjusted Basis	<u>50,000</u>	<u>72,000</u>

<u>Step 2:</u>		
Sales Price	\$120,000	\$120,000
Adjusted Basis	<u>50,000</u>	<u>72,000</u>
Gain	<u>70,000</u>	<u>48,000</u>

After the cost of the machinery is indexed, the accumulated depreciation is deducted to arrive at the Montana adjusted basis. There would be \$22,000 less gain reported under SB 6 with the indexing of the cost basis of the asset.

EXAMPLE #4

Assume the same facts as in the above example except the Sales Price was \$60,000.

Gain Under:	<u>Present Law</u>	<u>SB #6</u>
<u>Step 1:</u>		
Cost	\$100,000	$100,000 \times 1.22 = 122,000$
Depreciation	(50,000)	(50,000)
Adjusted Basis	<u>50,000</u>	<u>72,000</u>

Step 2:

Sales Price	\$ 60,000	\$ 60,000
Adjusted Basis	<u>(50,000)</u>	<u>(72,000)</u>
Gain	10,000	(12,000)

Under this example there would be \$22,000 less gain reported under SB 6 because of the indexing.

EXAMPLE 5 ASSET HELD PAST THE FEDERAL DEPRECIABLE LIFE

Asset purchased Jan. 1, 1990

Cost \$12,000

Annual Depreciation \$4,000 / year , 3yr. useful life

Inflation factor 1993 = 1.25

Depreciation Expense deducted on 1990, 1991, & 1992 returns totals \$12,000.

Additional Depreciation Expense deductible in 1993 =

Inflation factor X Cost Basis - Accumulated Depr. = Add'l Depr.

$$(1.25 \times \$12,000) - \$12,000 = \$3,000 \text{ Add'l Depreciation}$$

Per SB 6 as amended.

ROLL CALL VOTE

HOUSE TAXATION

COMMITTEE

DATE 6/29/89

BILL NO. SB6

NUMBER _____

NAME	AYE	NAY
Ben Cohen		✓
Jerry Driscoll		AM ✓
Jim Elliott		✓
Orval Ellison		✓
Leo Giacometto		✓
Bob Gilbert		✓
Susan Good		✓
Ed Grady		✓
Marian Hanson		✓
Robert Hoffman		✓
Mike Kadas	✓	
Francis Koehnke		✓
Mark O'Keefe	✓	
John Patterson		✓
Bob Raney	✓	
Dennis Rehberg		✓
Ted Schve	✓	
Barry Stang		✓
Jessico Stickney	✓	
Chuck Swysgood		✓
Bob Ream	✓	
Dan Harrington	✓	

TALLY

Norma Grace
SECRETARY

7 15
Dan Harrington
CHAIRMAN

MOTION: to table

