MINUTES

MONTANA HOUSE OF REPRESENTATIVES
52nd LEGISLATURE - REGULAR SESSION

COMMITTEE ON INCOME/SEVERANCE TAX

Call to Order: By **CHAIR BOB REAM**, on February 15, 1991, at 8:00 am.

ROLL CALL

Members Present:
- Rep. Bob Ream, Chair (D)
- Rep. Jim Elliott (D)
- Rep. Mike Foster (R)
- Rep. Bob Gilbert (R)
- Rep. Marian Hanson (R)
- Rep. Jim Madison (D)
- Rep. Bea McCarthy (D)
- Rep. Tom Nelson (R)
- Rep. Bob Raney (D)
- Rep. Barry Stang (D)

Staff Present: Lisa Fairman, Committee Secretary

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed.

Announcements/Discussion: **CHAIR REAM** announced HB 447 and SB 15 will be discussed.

EXECUTIVE RECOMMENDATION ON SB 15

Motion: **REP. JIM ELLIOTT MOVED SB 15 BE RECOMMENDED DO PASS.**

Discussion: **REP. ELLIOTT** stated he believed the tax referred to in the Senate bill is the only tax that includes Indian and government royalties. According to the Federal Constitution, the taxation appears to be unconstitutional. SB 15 will correct this situation. There appears to be no significant fiscal impact. **REP. BOB RANEY** responded that a loss of $100,000/year is significant. It may not be worth losing changing the tax by passing SB 15 until it is known if it is unconstitutional. **REP. BOB GILBERT** stated the Resource Indemnity Trust Tax (RITT) is an environmental fee. The proceeds are used to clean up environmental damage done by industry. The RITT is put in a different perspective than a severance tax. **REP. RANEY** asked who will benefit if SB 15 passes. **REP. GILBERT** responded that the Indians do because they don't pay RITT. **CHAIR REAM** asked The

Department of Revenue (DOR) to provide information. **Don Hoffman, DOR,** stated the beneficiaries are primarily the producers. In 1989, Indians were excluded from the RITT as a result of Blackfeet litigation. SB 15 addresses the governmental entities; the state, federal, county and municipal. There is inconsistency in current law. SB 15 brings state and federal royalties to the same status as the Indian royalties. All these entities are already excluded under oil and gas severance taxes. The bill provides uniformity throughout the whole taxation system. Item three in the bill is where the fiscal impact occurs. **CHAIR REAM** asked if those are royalties received by the federal, state or municipal governments on reservation. **Mr. Hoffman** clarified it is royalties on federal, state, or municipal land that have mineral rights reserved for Tribal or Indian people.

CHAIR REAM stated he understood subsections 1 and 2 addressing Tribes or individual Indians but did not understand the purpose of subsection 3. **Mr. Hoffman** stated, according to a Department of State Land (DSL) lease, when royalties are to paid to DSL they are to be free and clear of all costs. The producer can not deduct costs off the top. DSL wants 12.5% of the gross. The producer reports 100% of production to DOR and as a result gets taxed on that 100%. The effective rate of RITT that a producer pays on state, federal or municipal lands is higher than on private lands. The operator pays production taxes on behalf of all the royalty and working interest owners involved. Only when the law specifically states exclusions can the operator deduct any amount from the gross revenue generated from oil and gas production. **REP. RANEY** stated he felt this was a philosophical issue. He understood the Indian and Tribal exemptions but did not feel comfortable with including paragraph 3. He asked if paragraph 3 was unconstitutional. **Mr. Hoffman** replied he did not know but could consult with the legal staff. **CHAIR REAM** asked **REP. ELLIOTT** why he felt the current taxation was unconstitutional. **REP. ELLIOTT** questioned the senate amendment in subsection 3 "or county or municipal government". He said it is within the privy of the Montana constitution to tax those royalties. **CHAIR REAM** inquired if the fiscal note reflects county and municipal royalties. **Mr. Hoffman** responded it includes county and municipal because it is difficult to break them out. The amendment was by request of DOR to make the law consistent to the severance tax laws.

<u>Vote</u>: **SB 15 BE RECOMMENDED DO PASS.** Motion carried 8-2 with <u>**REPS**</u>. **RANEY** and **MADISON** voting no.

<u>Discussion on HB 447</u>

<u>Motion</u>: **REP. ELLIOTT MOVED HB 477 BE RECOMMENDED DO NOT PASS.**

<u>Discussion</u>: **REP. ELLIOTT** stated the bill refers to capital gains. A risk is a real and acceptable part of conducting business. The higher the risk, the larger the return. On current

income tax forms, capital gains that have been taken out are indexed as ordinary gains. The indexing mechanism is already in place for ordinary income. The payment of taxes on gains is accountable to inflation. Taxes are being paid on inflated dollars. Governments like to see inflation because they can pay off debt in inflated dollars. The sponsor of bill stated the bill provides a process to encourage savings for average person. Investment and savings are different things. Investments imply risk and savings imply low risk. HB 447 increases the exclusion of interest income. There needs to be an upper limit to these exclusions. **REP. ELLIOTT** stated he opposed the bill for the reasons he stated. **REP. RANEY** added there will be a loss of 18 million dollars in revenue in the biennium if the bill is passed. **REP. MCCARTHY** stated during the main Taxation committee, most of the discussion focussed on page 15, the section on taxable periods. The section is not easily understood or workable.

Motion: **REP. MCCARTHY MOVED TO RECOMMEND TO TABLE HB 447.**

CHAIR REAM suggested before we act on the motion to hear comments from DOR or Legislative Fiscal Analyst (LFA). **REP. MCCARTHY WITHDREW HER MOTION.**

Bob Turner, DOR Auditor, stated the Department is neutral on this subject. The bill applies to capital gains after December 1, 1990. Capital gains before and after December 1, 1990 would have to be indexed and figured separately. This could lead to two capital gains. The process can be done but it will require more record keeping for the Department and individual tax payer. DOR will require more money to finance the increased administrational costs. The process would not add to the simplification process. **CHAIR REAM** asked **Mr. Turner** if the increase in interest exclusion, in #3 on the fiscal note, is the interest income or the capital gain. **Mr. Turner** answered the interest exclusion. It would raise elderly exclusion from $800 to $960. **CHAIR REAM** stated the whole fiscal impact shown is attributed to tax on interest income. There is nothing to do with capital gains. **Mr. Turner** added capital gains are difficult to figure out. **CHAIR REAM** agreed especially if they are being carried for five years. **REP. MADISON** said long term affects of capital gains are addressed at the end of the fiscal note.

Jim Standard, LFA, added some people may want to establish residency in Montana because of the special treatment of gains. Montana may gain from this increase of people. **REP. GILBERT** pointed out if interest income is not excluded there will be no incentive to save. Interest income inflation eats up all the savings. This is a reason to consider the bill. However, the general fund will lose nearly $19 million if the bill is enacted. He stated he liked the idea of the exclusion but feels the state can't afford to lose that amount from the General Fund. **CHAIR REAM** said **REP. JOHN COBB,** sponsor of HB 447, does not have strong feelings about the bill and said there is another bill concerning interest income forthcoming.

Motion/Vote: **REP. RANEY MADE A SUBSTITUTE MOTION THAT HB 447 BE RECOMMENDED BE TABLED.** Motion carried unanimously.

ADJOURNMENT

Adjournment: 8:45

Bob Ream

BOB REAM, Chair

Lisa Fairman

LISA FAIRMAN, Secretary

BR/lf

HOUSE OF REPRESENTATIVES

INCOME/SEVERANCE TAX SUBCOMMITTEE

ROLL CALL DATE 2-15-91

NAME	PRESENT	ABSENT	EXCUSED
REP. JIM ELLIOTT	✓		
REP. MIKE FOSTER	✓		
REP. BOB GILBERT	✓		
REP. MARIAN HANSON	✓		
REP. BEA MCCARTHY	✓		
REP. JIM MADISON	✓		
REP. TOM NELSON	✓		
REP. BOB RANEY	✓		
REP. BOB REAM, VICE-CHAIR	✓		
REP. BARRY STANG	✓		
~~REP. DAN HARRINGTON, CHAIR~~			