MINUTES

MONTANA HOUSE OF REPRESENTATIVES
52nd LEGISLATURE - REGULAR SESSION

COMMITTEE ON TAXATION

Call to Order: By DAN HARRINGTON, CHAIR, on April 4, 1991, at 9:00 a.m.

ROLL CALL

Members Present:

Dan Harrington, Chairman (D)
Bob Ream, Vice-Chairman (D)
Ben Cohen, Vice-Chair (D)
Ed Dolezal (D)
Jim Elliott (D)
Orval Ellison (R)
Russell Fagg (R)
Mike Foster (R)
Bob Gilbert (R)
Marian Hanson (R)
David Hoffman (R)
Jim Madison (D)
Ed McCaffree (D)
Bea McCarthy (D)
Tom Nelson (R)
Mark O'Keefe (D)
Bob Raney (D)
Ted Schye (D)
Barry "Spook" Stang (D)
Fred Thomas (R)
Dave Wanzenried (D)

Staff Present: Lee Heiman, Legislative Council
Lois O'Connor, Committee Secretary

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

HEARING ON SB 151

Presentation and Opening Statement by Sponsor:

SEN. ECK, Senate District 40, Bozeman, stated SB 151 will extend the medicaid eligibility to pregnant women and to infants if the family income does not exceed 185% of the federal poverty threshold. An example of a family of three is if you have two parents and the women is pregnant. It is easy to assume that if their income is less than $19,000 a year, they will not be able to afford insurance unless their employer provides it. SB 151 would make medicaid services available.

Last year the federal government mandated that eligibility be increased to 133% of poverty. The reason for this is because it is cost affective to provide pre-natal care, good delivery care, and infant care. Last year, Montana had about 3,000 infant births a year at a cost of $8.3 million. Of the 3,000 babies, there were 129 that cost $4.2 million which means that half of the medicaid is spent on problem births. Of the 129 problem births, over half had no pre-natal care.

Under the new medicaid regulations, there is a presumption of eligibility so that even if a pregnant women isn't sure that she is eligible for medicaid, she is presumed eligible when she goes in for her first checkup. This is basically the reason for SB 151. The reason that we are having the hearing in the Taxation Committee is how we are going to fund it. As we all know, if you introduce a bill that needs funding, to keep it from getting deep-sized at the end of the session, you must have a funding source.

Last session, their was a proposal that put a tax on the people who had health insurance. She felt that was the opposite way that they should be going. SB 151 proposes to put a dollar a week charge to the employer for each employee who makes less than $6,000 a quarter or $24,000 a year and who doesn't have health insurance for that employee. The funds collected will go to pay for the increased costs SRS will incur for the increased coverage of medicaid.

SEN. ECK stated further that in looking at the fiscal note, the tax will bring in $1.1 million a year. SB 151 is a step towards providing a rational way of dealing with increasing health care costs, but it needs the funding.

Proponents' Testimony:

John Ortwein, Montana Catholic Conference, stated their concern is for the lives of both the child and mother. He had talked with **Bill Kopps, Catholic Health Association,** and he told him of a number of studies done on mental retardation and long term difficulties that can often be prevented by adequate pre-natal care. We see SB 151 as one step towards helping with these particular problems.

Diane Sands, Montana Women's Lobby, stated that SB 151 is a very creative cost effective way to meet the crisis of obstetrical health care for women and because it is an important part of breaking the cycle of poverty in the state. She introduced a letter from **Judy Smith, Women's Opportunity and Resource Development, Inc.,** which works with low income families. She thinks this is an important bill for addressing the need to keep people working and for giving our children a healthy start.
EXHIBIT 1

Paulette Kohlman, Montana Council for Maternal and Child Health, expressed her surprise that the business people of the state are opposing this bill. If you break down a dollar a week, to a normal employee's salary, it comes out to 2 1/2 cents an hour. These same people just had an increase in the minimum wage. This is minuscule compared to that. This is a tiny contribution that business people can make to the health of their future work force. If they provide insurance now, they will not be affected by this bill or any other bill. She wanted the committee to recognize that these small employers are paying for these cost whether they have insurance for their employees or not. Every time they check into a hospital, every time they visit a doctor, every time they make a payment to the medical system, a part of the payment is paying the medical system back for delivering the babies of uninsured women and for the care of sick infants who did not have adequate pre-natal care.

Jerry Loendorf, Montana Medical Association, stated that there are now 141,000 Montanans under age 65 who are uninsured. Since the chain organization have come into the state, they emphasize, low pay, minimum wage, and now hiring people on a part time basis to avoid paying benefits. As a result, there is a larger and larger population of uninsured people who can't take care of their health benefits.

Four percent of the babies in 1989, cost 51% of the medicaid budget for pre-natal and infant care. If we were to get these people in for early diagnosis, it would be an obvious savings. We have a need and the source to obtain the revenue is appropriate.

Opponents' Testimony:

Riley Johnson, National Federation of Independent Business, stated that small business is part of the solution. They view the bill as a good news, bad news situation. The good news is the cause; the bad news is the solution. Any tax, which is a mandatory tax on business, is targeting small business and asks the small business to solve social problems. That is exactly what we have--a social problem. The whole situation of health is a social problem, and the small business object to having to be the people who shoulder the responsibility of solving social problems when everyone else is out of money.

Secondly, the bill does not attack the issue. This is a very minuscule part of the SRS's medicaid problem. Thirdly, today we talk about pregnancy, pre-natal care; tomorrow we are going to talk about well-child care, and mandatory medicaid coverage. All of the costs will be laid back on the businesses. The door is opening on this, and the small business people oppose SB 151. They do, however, support HB 693 introduced by **REP. THOMAS.**

Charles Brooks, Montana Retail Association, stated that we are targeting the major retailers of the state. Small businesses know that they are part of the solution. The small businesses in the state are struggling and contemplating going out of business. This type of legislation is targeting the wrong people and will increase the problem. The small business would welcome the opportunity to provide health insurance if it were in their financial capability.

Roger Koopman, Personnel Leasing, offered two objections to SB 151. First, the bill would have an incredible hardship on temporary health services. There are 35 to 40 of them in the state and they are a vital function within the state's economy. A temporary service may have 100 people on their payroll for any given payroll period. Most of those employees will work a half day maybe two days typically spot type jobs. One hundred employees may sound like a lot, but it is very misleading because the actual wages being paid out proportionately is very small. People who come to them typically don't expect benefits and don't expect to earn a living by going into temporary service. They are just getting interim wages while they are looking for permanent employment. This legislation isn't applicable to temporary services. Secondly, Most temporary services, by nature, are very low profit small scale operations. They could not absorb this type of cost, and the costs are discriminatory. They do not reflect what is actually happening in terms of the actual profits of the temporary help service.

How will temporary help services respond? They will have to find a way of passing through those costs either by paying less in wages, charging a hire rate to their clients, or consider closing their doors. If this legislation passes, temporary services will look at the spot jobs and say that there is no incentive to provide these anymore.

Susan Brooke, Montana Stockgrowers Association, said that she rises in reluctant opposition to SB 151. She realizes that there is a problem and it needs to be addressed. Their major objection is that stockgrowers and farmers hire seasonal help to help harvest crops. Often time the profit margin is slim if at all. She encouraged the committee to either amend the bill exempting stockgrowers or kill the bill.

Laurie Shadoan, Bozeman Chamber, said that small businesses in Montana received an increase in minimum wage of .7% in the last two years. We have supported those increases, but you can not continue to balance the problems of the state on the backs of small businesses. She introduced a letter from **Express Services, Bozeman. EXHIBIT 2**

Doug Kelly, Express Services, Helena stood in opposition to SB 151.

Tom Hopgood, Health Insurance Association of America, stated that the reason that there are 141,000 uninsured people in Montana is because of the high cost of health insurance. There has to be an assumption that these 141,000 of people, who are not insured, can somehow afford this tax. If you can't afford to buy the health insurance for your employees, you can't afford to pay the tax.

James Tutwiler, Montana Chamber of Commerce, stated this issue has generated more interest and problems in his office than any other issue. The committee must consider the question as to whether this is the right approach to solve the health care problems.

Lorraine Gillies, Montana Farm Bureau; and Stuart Doggett, Montana Innkeepers and Manufactured Housing and RV Association; stood in opposition to SB 151.

Questions From Committee Members:

CHAIR HARRINGTON said that in **Roger Koopman's** testimony, he stated that it was not the employers responsibility for this health insurance and at the same time he says that it is not the governments either. He asked who's responsibility is it? **Mr. Koopman** said ultimately the responsibility should rest in the negotiating process when the person gets hired. He sees the continual cycle of government accepting more and more responsibility of all areas becomes a self-fulfilling situation. What you have is more and more of the wealth that is produced by the private sector put into the public sector. The private sector is so burdened that the resources aren't there to negotiate to provide our employees benefits. **CHAIR HARRINGTON** asked if **Mr. Koopman** negotiates with each person who comes to him for a job. **Mr. Koopman** said temporary workers never expect the benefits because it is not in the nature of temporary work.

REP. HOFFMAN said that the Title of the bill talks about family income not exceeding 185% of the federal poverty threshold, and asked **SEN. ECK** if that included what would be the gross income. **SEN. ECK** said that it is family income as defined by SRS and Medicaid. They have long definitions on how to define family income.

REP. REAM asked **SEN. ECK** why the bill covers the DOR costs and the fiscal note doesn't show it. **SEN. ECK** said DOR came in with a long list of amendments for administration. She questioned the 15%; but for the first year, she felt it appropriate. **REP. REAM** asked if there was general fund impact. **SEN. ECK** said the fiscal note shows a general fund impact because they had a earlier effective date. **Jeff Miller, DOR,** said the money that would be provided to the DOR would come from the taxes collected. So there should not be a general fund impact.

REP. ELLIOTT said that he agree with **Mr. Koopman** in that the government has assumed more responsibility in recent years in this respect. In his testimony, he stated that government has to recognize what the private sector has done for the employee over the past 200 years. He asked **Mr. Koopman** to delineate exactly what that has been. **Mr. Koopman** said we look at this nation and see a nation that because they believe in private initiative believe that the private sector can produce not one solution but dozens of solutions to the same situation. Our society has provided more good for more people than any other society. There is something to be learned from that. Private industry has provided a tremendous amount of benefits to workers over the years. More recently, it has become more difficult because of the burden of regulation and taxation.

REP. COHEN said that as everyone knows, he strongly opposed **REP. THOMAS'S** bill that would provide a credit for employers who don't have insurance and not to the employers who do. There are many employers who do provide health insurance and has it optional as to whether they want to cover the family. This is an election that the employee takes and it will be funded out of their own pocket. He asked **SEN. ECK** if an employer is providing insurance that is sufficient enough to cover the cost of his employee and the employee does not elect to cover his family, will that then require that his employer pay the dollar tax because the employee does not elect to cover his family. **SEN. ECK** said no, but maybe it should.

REP. GILBERT said he pays 70% of the insurance in his business and he requires the employee to pay 30% because if they have some of the responsibility they have less of a tendency to abuse the policy. But what if he has an employer who doesn't want insurance. As he reads the bill, it states an employer shall pay a tax for each employee who does not have health insurance coverage. This says that even though the employee doesn't want it the employer must still pay the tax. **SEN. ECK** that was something that could be written in the bill. On the other hand, if the employee doesn't want health insurance, it would sure be cheaper for him to pay a dollar a week than to pay for health insurance. **REP. GILBERT** asked if she thought that employers are obligated to buy health insurance for their employees just because they hire them. **SEN. ECK** said that she believes the whole obligation of employers needs to be looked at.

Closing by Sponsor:

SEN. ECK said that this is a bill that would cover a growing cost to government. She doesn't know how people in the private sector can say that the government is expanding unless they are saying that these people should not have health services. We are also looking at the fact that state government is providing subsidies to those businesses who don't provide health insurance.

EXECUTIVE ACTION ON SB 69

Motion/Vote: **REP. FAGG MOVED SB 69 BE CONCURRED IN.** Motion carried 20 to 1 with **REP. STANG** voting no.

EXECUTIVE ACTION ON SB 26

Motion/Vote: **REP. STANG MOVED SB 26 BE CONCURRED IN.** Motion carried 20 to 1 with **REP. GILBERT** voting no.

EXECUTIVE ACTION ON SB 288

Motion/Vote: **REP. McCARTHY MOVED SB 288 BE CONCURRED IN.** Motion carried unanimously.

HEARING ON SB 299

Presentation and Opening Statement by Sponsor:

REP. REAM made the opening statement for **SEN. HALLIGAN, Senate District 29, Missoula,** the sponsor of SB 299. He stated that the proponent would address the bill.

Proponents' Testimony:

Ward Shanahan, Attorney, Helena, said SB 299 is a bill to amend the present provisions involving interlocutory appeals from tax proceedings. This is a matter that has been wrangled over between lawyers, accountants, and DOR for many years. They got together and drafted this bill which corrects the procedural problem which will allow you to hear a tax case without having to go through a factual hearing before the state takes the appeal. He urged the committee's support.

Opponents' Testimony: None

Questions From Committee Members:

REP. RANEY asked **Ward Shanahan** what an interlocutory adjudication was. **Mr. Shanahan** said that when a tax proceeding is started, it begins with an informal hearing before the DOR. This is the opportunity for an informal discussion that either hardens or softens the discussion between DOR and the taxpayer. When you get to the end of that discussion, you have to go to the state Tax Appeal Board. The Tax Appeal Board is not composed of lawyers, and the courts have held that it doesn't have the right to make rulings on what statutes and regulations mean. The Tax Appeal Board hears the factual issues about property valuations. Interlocutory adjudication is a way of trying to speed up the proceedings and is called interlocutory because it takes place before a final decision on an issue.

REP. REAM asked **Geralyn Driscoll, DOR,** if they had any comments on this. **Ms. Driscoll** said that the DOR is supportive of SB 299.

REP. RANEY asked **Ward Shanahan** what would be the case where you would anticipate using this law. **Mr. Shanahan** said lets say the Legislature passes a new statute that is ambiguity to statute. The taxpayer takes one position and the DOR takes another. Rather than putting the taxpayer through the expense of an factual hearing, if you find out what the words mean, that could dispose of the issue. You take it to district court, the district court says "this is my decision on the issue". Usually with those types of issues, they have to go to the Supreme Court. So you get to the Supreme Court before you have to go through a three or four day hearing before the state Tax Appeal Board.

Closing by Sponsor:

REP. REAM made no closing statement.

EXECUTIVE ACTION ON SB 299

Motion/Vote: REP. McCARTHY MOVED SB 299 BE CONCURRED IN. Motion carried unanimously.

HEARING ON SB 333

Presentation and Opening Statement by Sponsor:

SEN. GAGE, Senate District 5, Cutbank, stated SB 333 is an act clarifying that a Montana shareholders of a corporation that is not incorporated in Montana and has not elected to be taxed as a Montana small business corporation, is subject to the same individual income tax treatment as a Montana shareholder of a corporation that is incorporated in Montana and has not elected to be taxed as a Montana small business corporation. He turned the explanation of SB 333 over to **Jeff Miller, DOR.** He provided the committee with amendments prepared by DOR which would grandfather those people who have cast their investment strategies and made plans and commitments on the bases of knowing that they would not have to file a Montana return. Recognizing that that was a legitimate concern DOR prepared amendments. He stated that he had no problems with them. **EXHIBIT 3**

Proponents' Testimony:

Jeff Miller, DOR, stated that DOR is in support of SB 333. The bill simplifies our existing law, it promote interstate uniformity, promotes equity, and it is good tax policy. He provided the committee with testimony which explained the difference between a Sub-S corporation and a C corporation. **EXHIBIT 4**

Gary Carlson, CPA, Helena, said he stood as a proponent because of the proposal to amend. The argument made by **Jeff Miller** on simplification is important. He stood in support of SB 333 as amended.

Mark Russell, Montana Society of CPA's, stood in support of SB 333.

Opponents' Testimony:

Tim Wylder, Attorney, Great Falls, provided written testimony. **EXHIBIT 5**

Ward Shanahan, Attorney, Helena, stated that as of December, 1990, DOR has not adopted a hard and fast decision on the issue. The problem he has with SB 333 is in the Title. The word "clarifying" is used. The word clarifying is a lawyer weasel word that has been given various interpretations by the Supreme Court. When you clarify something it means that this is the way we all believe it was. That is not the situation here. You are dealing with taxpayers who have done tax planning for themselves who are now faced with disputes with DOR, who under its own statute of limitation of 5 years wants to go back and reassess them for liabilities. He urged the committee to look at **Mr. Wylder's** proposed amendment.

Questions From Committee Members:

REP. THOMAS asked **Tim Wylder** if with the grandfather clause, doesn't that take most of the problems out of the bill. **Mr. Wylder** said yes as long as the Legislature as a body makes it clear that SB 333 is intended to address both of the issues raised. **REP. ELLISON** said his interpretation of what **Ward Shanahan** said is as long as they didn't go back the five years. **Mr. Shanahan** said that is the affect of the word "clarifying". It gives the DOR the ability to argue in a particular tax case that this is the way they have always meant it, but there is an ambiguity in the statute and we want to clarify that this is the way we have always done it.

CHAIR HARRINGTON asked **Jeff Miller** what his feeling is on **Mr. Wylder's** amendment. **Mr. Miller** said that he feels it changes considerably the intent of SB 333. It is addressing current law issue, and he is trying to bring into this discussion a completely separate issue. In fairness, the DOR in 1987 did change its position. **REP. ELLISON** asked if the changes in federal Sub-S affect Montana law. **Mr. Miller** said yes because DOR has followed lock-step. When they raised their shareholder limit, so did we.

Closing by Sponsor:

SEN. GAGE made no closing statement.

HEARING ON SB 177

Presentation and Opening Statement by Sponsor:

Jeff Miller, DOR, made the opening statement for **SEN. MAZUREK, Senate District 23, Helena,** sponsor of SB 177.

Proponents' Testimony:

Jeff Miller, DOR, gave background information to the committee. He stated that Montana has a provision called unclaimed or abandoned property. Since Montana is called a custodial state, property that is assumed to be abandoned is forwarded to the state if there has been no contact with the owner for a period of five years. The state, upon receipt, advertises to try to reunite the owner with there property. If we are successful, the owner comes forward and files an affidavit that states this is my property, here's my proof. If we can not find the owner; we, in effect, open an account with them. We deposit the money in the non-expendable education trust fund in there name. At that point, they or any of their heirs can come forward in perpetuity to claim the property. The principal of the money can never be spent, but the interest can be. Amendments to SB 177 address a number of administrative concerns. They clarify that abandoned property for "unknown owners" are subject to the custody of the state as unclaimed property.

SB 177 raises the minimum reporting thresholds on amounts to be reported separately from $10 to $25. This is an administrative convenience. It simplifies the reporting of remittance requirements; and it makes clear that there is no statute of limitations that a federal government or another state can raise as a defense to us making claim to the property. The federal government in notorious for ignoring the state requirement to forward these types of funds. They have to recognize that the abandoned properties come back to the state and not to them. Finally, the bill corrects the applicability date of the DOR's ability to estimate.

Opponents' Testimony: None

Questions From Committee Members:

REP. McCAFFREE asked **Jeff Miller** if a heir is found does DOR have to refund the interest the money incurred. **Mr. Miller** said no. The law requires that we maintain the principal forever in the name of the person; but the state, under the custodial state provision, that the custodial estate should come to one location and the public should benefit.

Closing by Sponsor:

SEN. MAZUREK made no closing statement.

EXECUTIVE ACTION ON SB 177

Motion: REP. STANG MOVED SB 177 BE CONCURRED IN.

Motion/Vote: REP. STANG moved to amend SB 177. **EXHIBIT 7**

Motion/Vote: CHAIR HARRINGTON MADE A SUBSTITUTE MOTION SB 177 BE CONCURRED IN AS AMENDED. Motion carried 20 to 1 with **REP. GILBERT** voting no.

EXECUTIVE ACTION ON SB 462

Motion: REP. STANG MOVED SB 462 BE CONCURRED IN.

Motion: REP. STANG moved to amend SB 462. **Lee Heiman, Legislative Council,** said that **SEN. WILLIAMS** wanted on Page 2, Line 25 to Page 3, Line 1--strike the subsections.

Discussion:

REP. FOSTER said just so he understands, when a telephone customer gets a bill that bill will itemize this tax. **REP. COHEN** said that it doesn't require that they do it, but present law states that they can not itemize this tax. It is not a tax to the consumer, it is a tax on the customer. **SEN. WILLIAMS** wants to remove the prohibition from itemizing it. **REP. FOSTER** said that utility bill are large, and if you are going to start line itemizing every tax that a customer is affectively paying it would be larger. **REP. STANG** disagreed in that if more people knew where their taxes were going, they might come to the Legislature and we can get rid of some of them. **REP. COHEN** said **SEN. WILLIAMS** only wants the prohibition removed. **REP. ELLISON** said that if your going to list taxes on the bill, then all taxes should be put on the bill.

Vote: Motion to amend SB 462 failed on a roll call vote. **EXHIBIT 8**

Discussion:

REP. FOSTER said that he has a problem with the bill. **SEN. MAZUREK** said that there growth was to be totally expected with the hotel and motel industry. He does not agree with the increase in the license tax rate from 1.725% to 1.8%. In questioning, **SEN. MAZUREK** stated that the double taxation creates a shortfall of $460,000. The tele-communications industry is rapidly growing and that growth will easily provide that $460,000. He doesn't think the increase is necessary. **REP. COHEN** said that the tele-communications people came in and testified in favor of the bill. He heard none of them say that they had a problem with the rate increase. **REP. FOSTER** said that he is not looking out for the tele-communications industry; he is looking out for the ratepayer who is ultimately going to have to

pay for this. There is no reason to do this. If you add the tax onto the growth the industry is going to have, the ratepayer is going to be putting more money into this than is needed.

Motion/Vote: **REP. FOSTER** moved to amend SB 462. To put back the rate increase to 1.725%. Motion failed 6 to 14 on a roll call vote. **EXHIBIT 9**

Motion/Vote: Motion SB 462 Be Concurred In carried unanimously.

ADJOURNMENT

Adjournment: 11:40 a.m.

Dan Harrington
DAN HARRINGTON, Chair

Lois O'Connor
LOIS O'CONNOR, Secretary

DH/lo

HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL **DATE** 4-4-91

NAME	PRESENT	ABSENT	EXCUSED
REP. DAN HARRINGTON	✓		
REP. BEN COHEN, VICE-CHAIRMAN	✓		
REP. BOB REAM, VICE-CHAIRMAN	✓		
REP. ED DOLEZAL	✓		
REP. JIM ELLIOTT	✓		
REP. ORVAL ELLISON	✓		
REP. RUSSELL FAGG	✓		
REP. MIKE FOSTER	✓		
REP. BOB GILBERT	✓		
REP. MARIAN HANSON	✓		
REP. DAVID HOFFMAN	✓		
REP. JIM MADISON	✓		
REP. ED MCCAFFREE	✓		
REP. BEA MCCARTHY	✓		
REP. TOM NELSON	✓		
REP. MARK O'KEEFE	✓		
REP. BOB RANEY	✓		
REP. TED SCHYE	✓		
REP. BARRY "SPOOK" STANG	✓		
REP. FRED THOMAS	✓		
REP. DAVE WANZENRIED	✓		

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 69 (third reading copy -- blue) be concurred in .

Signed: Dan Harrington

Dan Harrington, Chairman

Carried by: Rep. Fagg

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 26 (third reading copy -- blue) be concurred in .

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. Stang

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 288 (third reading copy -- blue) be concurred in .

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. McCarthy

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 299 (third reading copy -- blue) be concurred in .

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. Fagg

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 177 (third reading copy -- blue) be concurred in as amended .

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. Stang

And, that such amendments read:

1. Page 2, line 2.
Following: "abandoned"
Insert: "and subject to the custody of this state as unclaimed property"

2. Page 9, lines 14 through 17.
Strike: "by the" on line 14 through "government" on line 17

HOUSE STANDING COMMITTEE REPORT

April 4, 1991

Mr. Speaker: We, the committee on Taxation report that Senate Bill 462 (third reading copy -- blue) be concurred in .

Signed: _____
Dan Harrington, Chairman

Carried by: Rep. Harrington

Women's Opportunity and Resource Development, Inc.

EXHIBIT 1
DATE 4-4-91
HB SR 151

4/3/91

House Taxation Committee
Montana Legislature
Capitol Station
Helena, Montana 59620

Dear House Taxation Committee Members,

I am writing in support of Senator Dorothy Eck's bill to extend Medicaid coverage to pregnant women and infants in families that earn up to 185% of the Federal poverty level. This would provide health care coverage to the so called "working poor": families who earn too much to be on welfare but not enough to afford health insurance or non-emergency health care. Many of these women do not receive adequate prenatal care during their pregnancies and the result is a low-birth weight, high-risk infant with long term costly health care needs these families can not afford to pay for.

Extending medicaid coverage during pregnancy to prevent high risk infants is more cost effective than paying for the long term health care needs of these infants. Encouraging employers to provide this coverage for pregnant women and infants, as they provide unemployment insurance coverage, is an important way to ensure that low income working Montanans have access to adequate prenatal care.

From my work with people on welfare, I am very aware of the problems for low income people caused by the high cost of health insurance and health care. Health care costs are a primary cause of the welfare cycle, where single parents cycle between welfare and low wage employment. Many of the program participants report that they are on welfare due to emergency health care costs they could not afford to pay while they were working.

Based on my experience working with Montanans trying to achieve economic self sufficiency, I believe we need a new approach to providing health care in this country. Too many of us can not afford basic, minimal care which in the long run would be much cheaper than the emergency, high risk problems that result from the lack of this care. This proposal to extend Medicaid coverage to pregnant women and infants in families with income up to 185% of poverty is a step in the right direction.

Sincerely,

Judy Smith

EXHIBIT 2
DATE 4-4-91
HB SB 151

EXPRESS SERVICES
Temporary & Permanent Personnel

April 1, 1991

Montana House of Representatives
Taxation Committee
Helena, MT

Dear Law Makers:

Senate Bill 0151 has come to my attention because of the impact it would have on the temporary help industry. Since that is the business I am in, I am very concerned. The tax basis "$1.00 per week or a fraction of a calendar week..." as found in Section 3, Lines 5 & 6 would be very difficult for us to assess. Since we have many temporaries who work 8 hours one day and 3 another and then don't work again for a few weeks this would be most cumbersome! We have approximately 50 to 100 employees each week who work in this sporadic way! This would be an administrative nightmare to be taxed in this way!

Because of the uniqueness of the temporary help industry, should this bill become law, temporary help companies should be exempt from this tax!

I appreciate your taking this matter into consideration. If you have any further questions or concerns, please feel free to contact me.

Expressly yours,

Rina Donaldson

Rina Donaldson
Owner/Personnel Consultant

EXHIBIT 3
DATE 4-4-91
HB SB333

Amendments to Senate Bill 333
Third Reading Copy

Prepared by The Department of Revenue
(April 3, 1991)

1. Title, line 15
Following: "Purposes;"
Insert: "PROVIDING A LIMITED EXCEPTION ALLOWING CORPORATIONS THAT CURRENTLY USE S CORPORATION STATUS FOR FEDERAL FILING AND REGULAR CORPORATION STATUS FOR MONTANA TO CONTINUE THAT METHOD OF FILING."

2. Page 14, line 10.
Following ~~(1)~~
Strike: For purposes of this part,
Insert: Except as provided in 15-31-201 (2),

3. Page 14, Line 18.
Following "effective.
Insert: (2) A corporation that would otherwise be a small business corporation may continue to be subject to the taxes imposed by Title 15, Chapter 31 if all the following conditions are met:
(a) On [the effective date of this act] the corporation was doing business in Montana and had a valid federal Subchapter S corporation election but had not elected to be taxed as a Montana small business corporation.
(b) After [the effective date of this act] the corporation has not filed as a Montana small business corporation.
(c) The corporation files a corporate license tax return as required by 15-31-111 reporting all income or loss as determined under Title 15, Chapter 31 and attaches a copy of the federal Subchapter S corporate tax return.

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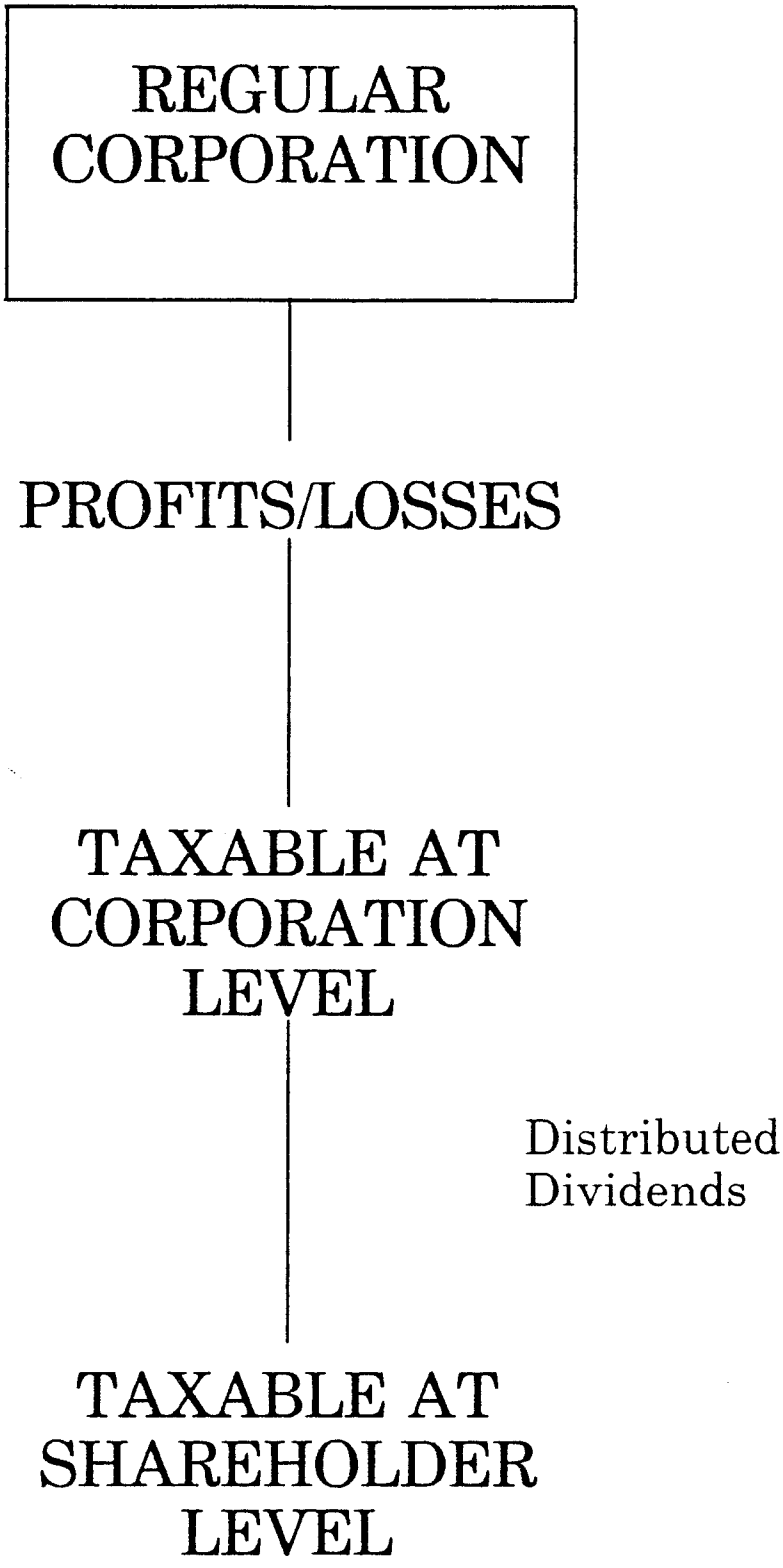

Ex. 4
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ions

Shareholders

ass of Stock

S CORPORATION

Key Features

- Pays no tax at federal level
- Pays $10 flat fee for Montana purposes
- To qualify as a Montana Sub S must elect for federal and for state §15-31-201

RP

10.00 Fee

S

PROFITS/LOSSES PASS THROUGH

- Whether distributed or not - included in shareholder Federal AGI

TAXABLE AT SHAREHOLDER LEVEL

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NON MONTANA S CORP

Elected for Federal

EXEPTION NOT AVAILABLE
NO NEXUS TO ELECT OUT

PROFITS/LOSSES

Reported By
MONTANA RESIDENT
SHAREHOLDER
(Included in their Fed. AGI)

CURRENT DEPARTMENT PRACTICE

Based on 1988 legal opinion - Department has consistently treated shareholder in out of state S Corps as being bound by Federal election.

1). Exception in § 15-31-111 not available.

2). Rely on our tie to Federal AGI - allow out of state Sub S losses - require out of state Sub S income be included

FEATURES OF SB0333

1). This bill will require this treatment for all Sub S Corporations and all resident shareholders. In other words, federal election controls state treatment - whatever is in shareholder's federal AGI is in MT AGI per § 15-31-111.

2). Election process for state is simplified - they attach a copy of federal election to first return filed. Continue to pay $10.00 flat fee in lieu of corporate tax.

3). Affirm the principle, residents taxed on 100% of income - to the extent taxed in another state they are allowed a credit against Mt. liability.

EXHIBIT 3
DATE 4-4-91
HB SB 333

Timothy J. Wylder
Attorney at Law
305 Liberty Center
9 Third Street North
Great Falls, Montana 59401

(406) 453-1966

April 4, 1991

Committee on Taxation
Montana House of Representatives

Re: Testimony on Senate Bill 333
Regarding Taxation of S Corporations

Mr. Chairman and Members of the Committee:

I practice business law and have dealt with the problems of small business taxation for over ten years. I am also personally involved with three S Corporations. Two are organized in Montana and do business in business in Montana; one is organized outside of Montana and does not do business in Montana. On behalf of myself and other Montana taxpayers similarly situated, I submit the following outline of my testimony in opposition to Senate Bill 333 as currently written and offer certain technical amendments to deal with my concerns.

I. **The Issue of Resident Shareholders of S Corporations Not Doing Business in Montana.**

Senate Bill 333 addresses a number of issues concerning Montana income taxation of S Corporations and their shareholders. One of the principal issues addressed by the Bill deals with Montana residents that own stock in S Corporations that are organized outside of Montana and do not do business in Montana. The issue has two parts and they are as follows:

1. **Gains.** Whether the Montana resident shareholder is taxable for Montana individual income tax purposes on the undistributed gains (income) of an out-of-state (foreign) S Corporation that does not do business in Montana?

2. **Losses.** Whether the Montana resident shareholder is allowed to use losses from a such a foreign S Corporation to reduce Montana taxes?

II. **Current Law.**

A. **Section 15-30-111(3), MCA (1989).** This Section provides in full as follows (See SB 333 at page 4-5) (emphasis added):

> In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's

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undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

This provision has been in the Montana Code since 1965.

B. **Interpretation.** There are no other statutes addressing this issue. On its face and by its plain language Section 15-30-111(3) clearly addresses both parts of the issue posed above and answers them in the negative. In short then, the current rule can be stated in short form as follows:

Part 1: Undistributed gains are excluded from Montana adjusted gross income (not taxed).

Part 2: Net operating losses are excluded from Montana adjusted gross income (do not reduce tax).

C. **Additional Support for This Interpretation.** As noted, the rule of Section 15-30-111(3) has been in effect since 1965. With the sole exception of the Department of Revenue personnel after 1987, the above interpretation has been accepted by every tax practitioner I have ever talked to about this issue, including Department of Revenue personnel before 1987. The Department's change of interpretation is discussed in Part III below. For further discussion of the above interpretation, see Exhibit A hereto, Excerpt from CCH Montana State Tax Reporter (1990) and Exhibit B hereto, "Memorandum of Law" from Timothy J. Wylder to Denis Adams dated March 23, 1990.

III. **The Department of Revenue Changes Its Position.**

A. **Prior to 1987.** Prior to 1987 the Department agreed with the above interpretation and confirmed its position to one of my CPA colleagues in connection with several corporations I was working with, including one of my own. See Exhibit C hereto, Letter from Kent Borglum, CPA to Denis Adams, dated May 29, 1990, regarding events of 1986.

B. **Events of 1987.** Sometime during 1987 a professor from the University of Montana School of Law persuaded a Department of Revenue hearings officer that, contrary to the plain language of Section 15-30-111(3), Part 2 of the rule set forth above, he should be allowed to used losses from an out-of-state S Corporation to reduce his Montana tax. The Department apparently acquiesced in this informal, unpublished decision. Subsequently, the Department's Legal Counsel issued an informal, unpublished Memorandum Opinion to justify the Department's change of position. See Exhibit D hereto, "Memorandum Opinion" from David W. Woodgerd to Ken Morrison, Administrator, Income Tax Division, dated October 14, 1987.

Note that with the exception of the taxpayer involved in the above case and Department personnel, no one knew, nor could anyone know by consulting published materials, that a change in the rules had purportedly taken place. Tax practitioners were presumably still advising their clients to take action based on the accepted rules of Section 15-30-111(3).

C. **Following 1987.** Based on its change of position in 1987, the Department in 1988 began assessing deficiencies against taxpayers with undistributed gains attributable to their ownership in foreign S Corporations. The Department's deficiency notices provided me with my first awareness that the Department had changed its position.

Note that even following the Department's 1987 change of position, unless a practitioner happened to have one of these unusual cases, he still would not have had any idea that the Department had changed its position. To the best of my knowledge, nothing was ever published by Department on this issue. Accordingly, if the issue came up, a practitioner would have advised that the rules of Section 15-30-111(3) apply as set forth above, that is, gains and losses are excluded in computing Montana adjusted gross income.

D. **Contested Cases.** Not surprisingly, taxpayers who had relied on the plain meaning of Section 15-30-111(3) and Department's assurances before 1987--in purchasing or investing in such corporations, making tax elections, and planning accordingly--contested the Department's new position.

IV. **Senate Bill 333--Requested by the Department of Revenue.**

A. **Background.** To resolve the controversy surrounding the issues raised above, and to its credit, the Department decided to seek legislative "clarification" on the issue. The Department worked with the Legislative Oversight Committee on Taxation and discussed a number of proposals. Then the Legislative Session began. The first draft out of Legislative Council confirmed what I take to be current law (contrary to the Department's post 1987 position), that is, gains and losses were to be excluded. In short, the old rules were to be retained.

In the meantime, however, support arose among certain legislators for reversing the current rules; they thought it was simpler if gains and losses were to be included. Senate Bill 333 was redrafted accordingly and introduced. As can be seen at pages 4-5 of the Bill, the language of Section 15-30-111(3), MCA (the old rule) has been deleted. The Bill went to hearing with very little scrutiny by tax practitioners. The Montana Society of CPA's testified that they favored it only because of its simplicity for future years and noted that its members had not had time to study it in any depth. The Bill

summarily passed the Senate Tax Committee and the full Senate with little further discussion.

B. **Merits of the Current Bill.** The Department will have testified as to the merits of the Bill. I will address their points briefly in light of what they say today. One thing is clear, however, simplicity is not served by changing a rule that taxpayers in many contexts have relied on for 25 years.

C. **Problems with the Current Bill.** As noted above, regardless of the merits of one set of rules over the other, by changing the rules in the middle of the game, Senate Bill 333 is manifestly unfair and creates tax headaches for taxpayers in many different S Corporation cases that have arranged their affairs and made their tax elections based rules in existence for 25 years.

1. **Examples.**

2. **Problems Magnified by the Tax Reform Act of 1986.** As a result of changes in federal corporation taxation in 1986, S Corporations have become much more desirable for profitable businesses. Accordingly, many S Corporation elections have been made since 1986 in Montana and elsewhere with regard to Montana.

3. **Problems Compounded by No Notice of Department's Change.** The many more S Corporation elections made after 1986 were all made without a clue that the Department had changed its position on Montana taxation of S Corporations and would seek legislation to confirm it.

D. **Solutions to the Problems.**

1. Kill the Bill and go back to the old rules.

2. Pass the Bill with the new rules, but allow for transition rules that will allow (and require in adverse cases) taxpayers who relied on the old rules to live by well established tax strategies, for better or worse. Losses and gains will vary by taxpayer.

V. **Proposed Amendments. See Exhibit E.**

A. **Title of the Bill.** The Title of the Bill should be amended to reflect the content of the Bill. As it now stands, the Title language reflects the first draft position that would have confirmed what I believe to be current law. It appears that when the Department changed its approach and a revised Bill was introduced, the Title was not revised to match the content of the Bill. Not only is the word "clarifying" not appropriate in my view, but the rule described in the first clause of the Title does not match the content of the Bill as introduced.

B. **Transition Rule.** Section 11(1) as amended would provide an acceptable transition rule for existing S Corporations and their shareholders in many situations that have arranged their affairs and made their tax elections based on 25 years of prior law.

C. **Technical Changes.**

1. Section 11(2) as amended would clarify that the Department is authorized to make administrative rules to implement the transition rules. authorized.

2. Section 11(3) is added to establish the supremacy of Senate Bill 333 in coordinating the Bill with other bills that may inadvertently address the tax law provisions affected by this Bill.

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EXHIBIT A

Other Adjustments

[¶ 15-470] **Other Montana Adjustments to Federal Adjusted Gross Income.**—In computing Montana adjusted gross income, other adjustments must be made to federal adjusted gross income as well as those additions and subtractions discussed above. These adjustments may be either "additions" or "subtractions," depending upon the taxpayer's situation.

An income adjustment between spouses may be made for income from a proprietorship if the proprietor's spouse performed services for the business. This adjustment is discussed at ¶ 15-472 below.

A shareholder of a Subchapter S corporation must also make certain adjustments to federal AGI, which are discussed at ¶ 15-474 below.

[¶ 15-472] **Adjustments for Spouses Filing Separate Returns.**—If a husband and wife file separate returns, each must report his or her own adjusted gross income. Income from personal services performed as an employee or as an independent contractor must be reported by the spouse who earned it. Income from rents, royalties, dividends, and interest must be reported by the spouse who owns the property from which the income is derived. If property is jointly owned by spouses, the income from it must be allocated according to each spouse's legal right to the income.

The income from a proprietorship business must be reported in full by the spouse who is the proprietor. If, however, the proprietor's spouse regularly and systematically renders substantial personal services to the business and is not paid a salary, the proprietor and the spouse may agree that the spouse earned an amount equal to reasonable compensation for services rendered, and that amount is deemed taxable to the spouse rendering the service rather than to the proprietor (.06).

A special rule is applied to married taxpayers who file a joint federal income tax return and who must include part of their social security benefits or part of their tier 1 railroad retirement benefits in federal adjusted gross income. Such married taxpayer may split the federal "base" used to calculate federal taxable social security benefits or federal taxable tier 1 railroad retirement benefits when they file separate Montana income tax returns (.01). The federal base must be split equally on the Montana returns (.01). The federal base is $32,000 for a joint return and $25,000 for a single return. A portion of the taxpayer's social security benefits or tier 1 railroad retirement benefits is subject to federal taxation if the taxpayer's "modified adjusted gross income" plus one-half of such social security or tier one railroad retirement benefits exceed such "base" amounts.

.01 MCA 15-30-111(6), ¶ 94-932c.

.06 ARM 42.15.322, ¶ 19-133.

.17 **IRA deductions**—The Technical Corrections Act of 1988 has changed the amount married people filing separately may be able to claim as an IRA deduction. The Act makes the instructions in the Montana tax booklet for 1988 on IRA's outdated. Under the old law, if a married person filed separately the IRA limitations applied only if that person was eligible for or covered by a qualified pension plan. Under the new law, even if a married person files separately, he or she is automatically considered covered by a qualified pension plan if his or her spouse is and, thus, they are subject to the IRA limitations. *Notice to Tax Practitioners,* Department of Revenue, February 23, 1989.

[¶ 15-473] **Adjustments for Senior Citizens.**—A taxpayer who is at least 65 years old is entitled to subtract from his or her federal adjusted gross income all interest income of up to $800 if filing separate return or $1,600 if filing a joint return (.01).

.01 MCA 15-30-111(2) ¶ 94-931.

[¶ 15-474] **Adjustments for Shareholders of Subchapter S Corporations.**—The law provides:

Law 15-30-111. * * * (3) In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of

Law

1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S. election were not in effect.

Shareholders of small business corporations which have elected to be taxed under Subchapter S for federal income tax purposes, but have not made the corresponding election under Montana law for state income tax purposes, must *add back to their federal AGI* the following items in computing their Montana AGI: Any actual distributions received from an electing small business corporation if the dividends would have been taxable for federal purposes had the corporation not made the Subchapter S election.

Shareholders must *subtract from their federal AGI* the amount of any undistributed taxable income, net operating loss, capital gains, or other gains, profits, or losses passed through to the shareholders by small business corporations which have elected to be taxed under Subchapter S for federal purposes but have not made the corresponding state election.

[¶ 15-476] Adjustments for Estates and Trusts.—The law provides:

Law

15-30-135. Tax on beneficiaries or fiduciaries of estates or trusts.— (1) A tax shall be imposed upon either the fiduciaries or the beneficiaries of estates and trusts as hereinafter provided, except to the extent such estates and trusts shall be held for educational, charitable, or religious purposes, which tax shall be levied, collected, and paid annually with respect to the income of estates or of any kind of property held in trust, including:

(a) income received by estates of deceased persons during the period of administration or settlement of the estate:

(b) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests;

(c) income held for future distribution under the terms of the will or trust;

(d) income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals, and the income collected by a guardian of a minor, to be held or distributed as the court may direct.

(2) The fiduciary shall be responsible for making the return of income for the estate or trust for which he acts, whether the fiduciary or the beneficiaries are taxable with reference to the income of such estate or trust. In cases under subsections (d) and (e) of subsection (1), the fiduciary shall include in the return a statement of each beneficiary's distributive share of such net income, whether or not distributed before the close of the taxable year for which the return is made.

(3) In cases under subsections (a), (b), and (c) of subsection (1), the tax shall be imposed upon the fiduciary of the estate or trust with respect to the net income of the estate or trust and shall be paid by the fiduciary.

If the taxpayer's net income for the taxable year of the estate or trust is computed upon the basis of a period different from that upon the basis of which the net income of the estate or trust is computed, then his distributive share of the net income of the estate or trust for any accounting period of such estate or trust ending with the fiscal or calendar year shall be computed upon the basis on which such beneficiary's net income is computed. In such cases, a beneficiary not a resident shall be taxable with respect to his income derived through such estate or trust only to the extent provided in 15-30-131 for individuals other than residents.

(4) The fiduciary of a trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund

Exhibit # 5
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EXHIBIT b

MEMORANDUM OF LAW

March 23, 1990

FROM: Timothy J. Wylder, Attorney at Law

TO: Denis Adams, Director, Montana Department of Revenue

ISSUE

Issue: Whether a Montana resident individual recognizes income for Montana individual income tax purposes on the undistributed income of a foreign corporation that has a valid federal S corporation election, but which does not do business in Montana, and therefore cannot elect under MCA 15-31-202?

CONCLUSION

No. MCA 15-30-111(3) applies to this issue by its plain language and provides that such income is excluded from the shareholder's adjusted gross income. Even if MCA 15-30-111(3) does not apply, there is no authority to attribute the corporation's undistributed income to its shareholders.

I

ANALYSIS OF THE ISSUE

Montana individual income tax is imposed upon the "taxable income" of individuals subject to tax. MCA 15-30-103. "'Taxable income' means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter." MCA 15-30-101(16). MCA 15-30-111(3) provides as follows (brackets and emphasis added):

> [1] In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect [2] but with respect to which the election provided for under 15-31-202, as amended, is not in effect, [3] adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

There are no other statutes directly addressing this issue. On its face and by its plain language MCA 15-30-111(3) clearly addresses the issue posed here and answers it in the negative. Our issue poses (1) "a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect," (2) "but with respect to which the election provided for under 15-31-202, as amended, is not in effect." The statute then provides (3): "adjusted gross income does not include any part of the corporation's undistributed taxable income . . . ." The only difference between the actual statutory language and the issue posed here is the reason that the corporation in this case has not elected under MCA 15-31-202, namely, that it is ineligible to do so under MCA 15-31-201 because it does not, by assumption, do business in Montana.

MCA 15-30-111(3) does not address the various reasons a corporation may not have filed a Montana S corporation election under MCA 15-31-202. A corporation may not have been eligible as in this case; it may have neglected to make the filing; or it may

have chosen not to elect because it is more advantageous under the respective rate structures to be treated as an S corporation for federal purposes and a C corporation for state purposes.

MCA 30-15-111(3) does not address any of the reasons for not electing S corporation treatment under MCA 15-31-202; it simply sets forth the resulting tax consequences. Accordingly, a strong argument can be made that such reasons are not relevant. If the reasons for non-election were relevant to the application of the rule, they would have been set forth in the statute. When a statute clearly answers a legal question on its face in plain language, there is no justification for speculating on the various cases the legislature may have actually contemplated. The Montana Supreme Court recently stated:

> We first note the general rule of statutory interpretation found in § 1-2-102, MCA, which states that legislative intent controls. Legislative intent is to first be determined from the plain meaning of the words used, and if interpretation of the statute can be so determined, the courts may not go further and apply any other means of interpretation. Boegle v. Glacier Mountain Cheese Co. (Mont. 1989) 777 P.2d 1303, ____, 46 St. Rep. 1389, 1391 (emphasis added).

Similarly, in a recent property tax case the Court recited:

> [T]he well accepted principle of statutory construction that the function of this Court is to interpret the intention of the legislature, if at all possible, from the plain meaning of the words used, and if the meaning of the statute can be determined from the language used, this Court is not at liberty to add or detract language from the statute in question. Department of Revenue v. Gallatin Outpatient Clinic, Inc. (Mont. 1988) 763 P.2d 1128, ____, 45 St. Rep. 2025, 2028 (emphasis added).

Therefore, because MCA 15-30-111(3) applies to the issue at hand in plain, clear language, no further analysis of legislative intent is required or justified.

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II

ANALYSIS OF THE MEMORANDUM OPINION

Reference is made to a Department of Revenue Memorandum Opinion, dated October 14, 1987, concerning taxation of gains and losses from out-of-state S corporations. The Memorandum Opinion begins its analysis on page 3 by acknowledging that MCA 15-3-111(3) answers the issue posed here on its face, but the author characterizes such a reading as "strict and technical." Actually, a plain reading gives a plain answer as demonstrated above. If by "strict" the author means limited to its plain meaning, then so be it. It certainly does not require a technical reading to reach the plain result. Any person applying basic plain English logic will get the same result. Only by taking a technical approach can one begin to consider other alternatives. That approach, of course, is contrary to the plain meaning rule adopted by the Montana Supreme Court.

Having thus summarily disposed with the plain meaning approach as "strict and technical," the Memorandum Opinion poses the question: "[W]hether the legislature intended by enacting § 15-31-111(3) [sic] to exclude gains and losses from out-of-state 'S' corporations from the adjusted gross income of Montana residents." The Memorandum Opinion argues that had the legislature intended the statute to apply to the case at hand, namely, an S corporation not doing business in Montana, (1) "it would have been much more clear," and (2) "it could easily have set forth an absolute exclusion of such gains and losses . . . ."

Concerning part (1) of the argument, it was noted above that there are several reasons why a corporation with a valid federal S corporation election might have no S corporation election in effect under MCA 15-31-202. The legislature chose not to address any of the reasons in the statute. As argued above, this supports the view that the various reasons for non-election are not relevant. The legislature just set forth the tax consequences as a matter of policy. As to part (2) of the argument, the legislature did "set forth and absolute exclusion of such gains and losses . . . ." MCA 15-30-111(3) is absolute; there are no qualifiers concerning reasons for having no election in place.

The Memorandum Opinion then makes the "impossibility" argument as follows:

> In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by § 15-30-111(3) is interpreting this statute to require an impossibility.
>
> It is a well known maximum jurisprudence that "[T]he law never requires impossibilities." § 1-3-22, MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana.

There appear to be several flaws in this reasoning. First, the proposition in the first sentence is misstated. It is only by interpreting MCA 15-30-111(3) to include gains or losses that requires the impossibility, that is, an election by a corporation not doing business in Montana, which ipso facto is not eligible under MCA 15-31-201. But, properly stated, this argument proves the opposite. If interpreting the statute to require inclusion of

such gains and losses requires an impossibility, then the statute should not be interpreted that way; rather it should be interpreted to require exclusion of gains and losses.

The concept of "impossibility" may be misused here in any case. It is "impossible" for a corporation not doing business in Montana to elect under MCA 15-31-202, and, therefore, impossible for its Montana shareholders to include the gains and losses for such corporation. But that is only to say that the corporation is ineligible. Under Subchapter S of the Internal Revenue Code, it is impossible for any corporation to be a shareholder of an S corporation, but that does not mean that other shareholders of such a corporation should be given S corporation treatment to avoid the "impossibility" of being ineligible. There is no impossibility in this case; there is just ineligibility and a policy decision set forth in plain language that certain tax consequences follow from the absence of an election.

Note also that the requirement of "doing business in Montana" under MCA 15-31-201 makes perfect sense in its context, that is, Chapter 31, MCA concerning the corporation income tax. A corporation is subject to tax only if it is doing business in Montana. MCA 15-31-101. If a corporation is not doing business in Montana, there is no corporation tax, and thus, there is no need to elect not to be subject to it.

III

FURTHER ANALYSIS

At the beginning of the Memorandum we applied MCA 15-30-111(3) and the plain meaning rule of the Montana Supreme Court to the

current issue and concluded that a plain answer resulted and further analysis was not justified. In the previous Section we analyzed the arguments in the Memorandum Opinion that reached a contrary conclusion and found them wanting. Although we believe the plain language approach discussed in Section I of this Memorandum is dispositive of this issue, others may feel a need for a more technical approach.

Let us assume for the sake of argument that the legislature did not subjectively intend for MCA 15-30-111(3) to apply to S corporations not doing business in Montana; it just did not have this case in mind. The analysis does not end there, however. We must then ask what rule should apply in the case of S corporations not doing business in Montana? Is there a good reason to reach the opposite result as set forth in MCA 15-30-111(3)? Further statutory analysis and the basic principles of income taxation suggest not.

First, even if one assumes that MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, the courts frequently and properly apply existing statutes to analogous situations even if the statutes do not directly apply. The existing statutes are the most legitimate source of public policy from which the courts can make law in the absence of a directly applicable statute. MCA 15-30-111(3) is the only statute directly relevant to this case. Accordingly, a court would be more likely to apply this rule than to decide that the opposite rule should apply.

Further analysis of the corporate and individual tax statutes other than MCA 15-30-111(3) also leads one to conclude that undistributed corporate income cannot be attributed to the corporation's shareholders. Because the corporation in this case does not do business in Montana, it is not subject to the Montana corporation income tax as noted above. By what authority then are its Montana shareholders subject to tax on the corporation's undistributed income? There is no statute that requires this. Indeed, MCA 15-30-202 demonstrates that a special statute and an affirmative election are required to attribute the income of a corporation to its shareholders. Thus, unless a special statute provides to the contrary, a corporate entity is respected for tax purposes.

Is there something in Chapter 30, MCA, concerning individual income tax that causes a shareholder to be taxable on a corporation's undistributed income? MCA 15-30-101(7) provides as follows (emphasis added):

> "Gross Income" means the taxpayer's gross income for federal income tax purposes as defined in section 61 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

MCA 15-30-111(1) provides in part as follows (emphasis added):

> Adjusted gross income shall be the taxpayer's federal income tax adjusted gross income as defined in section 62 of the Internal Revenue Code of 1954 or as that section may be labeled or amended . . . .

IRC § 62(a) provides in part as follows:

> For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions . . . .

The Montana individual income tax is clearly predicated on Section 61 of the Internal Revenue Code. Under the long established principles of IRC § 61, a cash basis taxpayer is not taxable on income unless is it actually or constructively received. A corporation's undistributed income is not actually or constructurally received by its shareholders (unless such income were indirectly applied to satisfy the shareholder's obligations, a case not presented here). IRC § 61 does not cause corporation income to be attributed to shareholders; that is accomplished only by the special provisions of Subchapter S of the Internal Revenue Code, IRC § 1366 in particular. Thus, there is no authority under IRC § 61 and derivatively no authority under MCA 15-30-101(7) to attribute a corporation's income to its shareholders.

In summary, this Section has argued that even if MCA 15-30-111(3) was not originally intended to apply to S corporations not doing business in Montana, it should be applied to them anyway as the closest applicable rule.

The last two paragraphs have demonstrated that even if we assume that the statute was not originally intended to apply to the facts of this case, there is no authority for attributing the income of a corporation to its shareholders in any case in the absence of an applicable statute to that effect.

EXHIBIT C

COPY

Exhibit # 5
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Junkermier · Clark
Campanella · Stevens · P.C.
Certified Public Accountants

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May 29, 1990

Denis L. Adams, Director
Montana Department of Revenue
Mitchell Building
Helena, MT 59624

Dear Denis:

Thanks for taking the time during tax season to meet with Tim Wylder and me on the non-Montana S-Corporation taxation issue. We have not heard anything from your department as to the status of your predicament, so we are assuming that your office is still working on it.

So that you know JCCS' position in this matter, I would like to briefly reiterate that we looked into this issue in the fall of 1986. In fact, our time sheets, phone logs and other documents show that our research was substantially done prior to October 12, 1986. When we were reviewing the tax aspects of forming these out-of-state corporations, I (personally) talked to Lynn Chenoweth to (1) confirm our interpretation of the applicable statutes and (2) discuss the character of any distributions taken. It is my understanding that he discussed the issue with someone else in your department prior to his final phone call to me.

Included in our research notes is documentation that this type of corporate setup is also in operation with California shareholders of a Nevada S-Corporation with the identical result your office advised us on; that is, no California tax on the S-Corporation income until the income is actually distributed. The income cannot be reflected on the individual's state tax return because the S-Corporation did not (and cannot) make a valid state S-Corporation election. If the legal opinion set forth by your department's attorney was correct, there would be no reason to need a form or procedure to elect S-Corporation status in Montana, would there?

*** PLEASE NOTE that this issue has been raised by your Department before. We have received permission from another one of our clients to recap the following scenario for you.

[redacted] treasurer for [redacted], filed a Federal S-Corporation election on October 31, 1980. He did not file properly for a Montana election. JCCS did not know about him filing for the election until after he had done it and so assumed he did everything correctly. The Department notified [redacted] in 1982 of the improper filing under MCA Section 15-31-202 and that it did not have a valid election for the fiscal year ended September 30, 1981. The Department concluded that [redacted]

[redacted] Exhibit # 5
4-4-91 SB 333

[redacted] was a regular corporation for income tax purposes and assessed tax, interest, and penalties on the Corporation. (JCCS had filed their Montana corporate return as if it were an S-Corporation). The Department also forced amended returns for all shareholders (see your file on [redacted] for example) to remove items of corporate income, deduction and ITC as shown on the Schedule K-1's from the shareholder's personal returns. We have documentation on all of this in our files.

The bottom line, Denis, is that it appears to me that not only has the Department of Revenue given assurance verbally that our tax treatment is the correct one, but it has demonstrated by its own actions and assessments that we are right. How then can the Department take an opposite stand now?

We feel that we are correct with our views in this matter. We also feel that the Montana Code is clear as it is written and that there is no reason to wait for the next Legislative session to fix something that is not broken. It is black and white, not gray, and the Department agreed with us only a short time ago.

Please advise us as to the status of this situation and I will relay the information on to our clients. Thanks.

Sincerely,

JUNKERMIER, CLARK, CAMPANELLA, STEVENS, P.C.
Certified Public Accountants

K Borglum

Kent A. Borglum, CPA

EXHIBIT D

Exhibit # 5
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COPY

MEMORANDUM OPINION REV/OLA 87-61

TO: Ken Morrison, Administrator
Income Tax Division

FROM: David W. Woodgerd, Chief Legal Counsel
Office of Legal Affairs

DATE: October 14, 1987

SUBJECT: Individual Income Tax - Taxation of gains and losses from out-of-state "sub-S" corporations

ISSUE

Should the gains and losses of an out-of-state "sub-S" corporation which are attributable to Montana residents be included in Montana adjusted gross income?

CONCLUSION

The gains and losses from out-of-state "sub-S" corporations received by Montana residents should be included in their adjusted gross income.

DISCUSSION

As you are well aware, Montana exempts small business corporations from its corporate license tax if they so elect and meet certain criteria.

> §15-31-202. Election by small business corporation. (1) A small business corporation may elect not to be subject to the taxes imposed by this chapter.
> (2) If a small business corporation makes an election under subsection (1), then: (a) with respect to taxable years of the corporation for which such election is in effect, such

> corporation is not subject to the taxes imposed by this chapter and, with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such corporation; and (b) with respect to the taxable years of a shareholder of such corporation in which or with which the taxable years of the corporation for which such election is in effect end, the provisions of this part apply to such shareholder, and with respect to such taxable years and all succeeding taxable years, the provisions of this part apply to such shareholder.
>
> (3) An election under subsection (1) must be made in accordance with rules prescribed by the department of revenue.
>
> (4) This election is not effective unless the corporate net income or loss of such electing corporation is included in the stockholders' adjusted gross income as defined in 15-30-11.
>
> (5) Every electing corporation is required to pay the minimum fee of $10 required by 15-31-204.

Small business corporations are those corporations which are "doing business in Montana" and have made an election pursuant to subchapter S of Chapter 1 of the Internal Revenue Code. 15-31-201(1), MCA. They are commonly referred to as "sub-S" or "S" corporations.

The gain or loss from an "S" corporation flows through to the individual shareholder for both federal and state purposes and is included in the individuals adjusted gross income. §15-30-111, MCA. However, pursuant to subsection (3) of §15-30-111, MCA, if a corporation which has filed a valid "S" election for federal purposes does not file an election for state purposes as required by §15-31-102, MCA, the gain or loss is not included in Montana adjusted gross income for the individual. Because no election has been filed in Montana the corporation is subject to the Montana Corporation License Tax and the gain or loss will be included in the income of that corporation.

The question which Erv Hall poses in his request for an opinion concerns "S" corporations having a valid election for federal purposes but which do not "do business" in Montana; have no nexus with Montana and therefore are not a "small business corporation"

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for Montana purposes. These corporations can not qualify for an election under §15-31-202 because they do not "do business" in Montana. Indeed, because no nexus exists they are not taxable by the state of Montana and have no need to file an election making them exempt from taxation.

A strict and technical reading of §15-30-111(3) indicates that because no Montana election is filed, the gains and losses from an out-of-state "S" corporation received by an individual in Montana would not be included in Montana adjusted gross income.

> §15-30-111(3). In the case of a shareholder of a corporation with respect to which the election provided for under subchapter S. of the Internal Revenue Code of 1954, as amended, is in effect but with respect to which the election provided for under 15-31-202, as amended, is not in effect, adjusted gross income does not include any part of the corporation's undistributed taxable income, net operating loss, capital gains or other gains, profits, or losses required to be included in the shareholder's federal income tax adjusted gross income by reason of the said election under subchapter S. However, the shareholder's adjusted gross income shall include actual distributions from the corporation to the extent they would be treated as taxable dividends if the subchapter S election were not in effect.

It is my understanding from Erv Hall's memorandum of August 18, 1987 and from a conversation with him, that the division policy in the past has been to disallow the deduction of losses from out-of-state. "S" corporations when claimed by Montana residents. Additionally, I understand that in certain cases, gains from out-of-state "S" corporations may have been included in a Montana resident's adjusted gross income.

Also, based upon discussions with Erv, I understand that in the case of partnership income, which is another type of "passive" income, both gains and losses are included as part of an individual resident's adjusted gross income.

It seems clear, as Erv has stated, that the policy and practice of the Department needs to be consistent as between gains and losses from out-of-state "S" corporation income.

One point of view is that since the out-of-state "S" corporation does not have an opportunity to elect under §15-31-202, MCA, the exclusion of gains and losses should not apply. The other point of view is that the statute requires an election and if it is not made, neither the losses or the gains can be included in adjusted gross income.

The issue is whether the legislature intended by enacting §15-31-111(3) to exclude gains and losses from out-of-state "S" corporations from the adjusted gross income of Montana residents. There are no legislative minutes available to use as guidance as to intent. However, it seems clear that if in fact this was the legislature's intent, it would have been much more clear. In other words, it could easily have set forth an absolute exclusion of such gains and losses rather than doing it in such a round-about manner. In effect, an interpretation that out-of-state "S" corporation gains and losses are excluded by §15-30-111(3) is interpreting the statute to require an impossibility.

It is a well known maxim of jurisprudence that "[T]he law never requires impossibilities." §1-3-222,MCA. In fact, it is impossible for an out-of-state "S" corporation to effectively elect under 15-31-202, MCA. Therefore, the requirement is nonsensical. The more reasonable interpretation is that the statute only requires an election when the corporation is "doing business" in Montana. [illegible] effect.

Therefore, it is my opinion that both gains and losses of an out-of-state "S" corporation should be included in a Montana resident's adjusted gross income.

CMW/jb

Exhibit # 5
4-4-91 SB 333

EXHIBIT

TIMOTHY J. WYLDER

PROPOSED AMENDMENTS
TO
SENATE BILL 333

April 4, 1991

The first clause of the Title to Senate Bill 333 (before the first semicolon) is amended to read as follows:

A BILL FOR AN ACT ENTITLED: "AN ACT FIRST REQUIRING THAT A MONTANA SHAREHOLDER OF A CORPORATION THAT IS NOT INCORPORATED IN MONTANA AND HAS ELECTED SUBCHAPTER S. CORPORATION STATUS FOR FEDERAL PURPOSES IS SUBJECT TO THE SAME INDIVIDUAL INCOME TAX TREATMENT AS A MONTANA SHAREHOLDER OF MONTANA CORPORATION THAT HAS ELECTED SUBCHAPTER S CORPORATION STATUS; . . ."

Section 11 of Senate Bill 333 is amended to read as follows:

NEW SECTION. Section 11. Effective dates -- applicability. (1) Except for the purposes of subsection (2), [this act] is effective December 31, 1991, and applies to any corporation (and any shareholder with respect to such corporation) that has made a valid election under Subchapter S. of Chapter 1 of the Internal Revenue Code first effective in any tax year beginning after December 31, 1991.

(2) For the purpose of promulgating administrative rules to implement [sections 1 through 11], [this act] is effective on passage and approval.

(3) [This act] reflects the Legislature's specific and focused policy judgement on taxation and tax administration of S. Corporations and their shareholders and therefore shall supersede the provisions of any other act including S. Corporation provisions to the extent that such other provisions, if any, are inconsistent with the purposes of [this Act].

EXHIBIT 6
DATE 4-4-91
HB SB 177

Amendments to Senate Bill 177
Third Reading Copy

Requested by the Department of Revenue

1. Page 2, line 2.
Following: "abandoned"
Insert: "and subject to the custody of this state as unclaimed property"

2. Page 9, lines 14 through 17.
Following: "1991," on line 14
Stike: "by" on line 14 through "government" on line 17.

EXHIBIT 7
DATE 4-4-91
HB SB 177

Amendments to Senate Bill No. 177
Third Reading Copy

For the Committee on Taxation

Prepared by Lee Heiman
April 4, 1991

1. Page 2, line 2.
Following: "abandoned"
Insert: "and subject to the custody of this state as unclaimed property"

2. Page 9, lines 14 through 17.
Strike: "by the" on line 14 through "government" on line 17

EXHIBIT 8
DATE 4-4-91
HB SB 462

HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL VOTE

DATE _____ **BILL NO.** 462 **NUMBER** _____

MOTION: DP A. conic.

NAME	AYE	NO
REP. BEN COHEN, VICE-CHAIRMAN		✓
REP. ED DOLEZAL	—	
REP. JIM ELLIOTT		✓
REP. ORVAL ELLISON		✓
REP. RUSSELL FAGG PR		✓
REP. MIKE FOSTER		✓
REP. BOB GILBERT PR	—	
REP. MARIAN HANSON		✓
REP. DAVID HOFFMAN	✓	
REP. JIM MADISON		✓
REP. ED MCCAFFREE		✓
REP. BEA MCCARTHY	✓	
REP. TOM NELSON		✓
REP. MARK O'KEEFE	✓	
REP. BOB RANEY PR		✓
REP. BOB REAM, VICE-CHAIRMAN PR		✓
REP. TED SCHYE		✓
REP. BARRY "SPOOK" STANG	✓	
REP. FRED THOMAS	✓	
REP. DAVE WANZENRIED PR		✓
REP. DAN HARRINGTON, CHAIRMAN		✓
TOTAL		

5 : 14

EXHIBIT 4
DATE 4-4-91
HB SB 462

HOUSE OF REPRESENTATIVES

TAXATION COMMITTEE

ROLL CALL VOTE

DATE 4-4 **BILL NO.** 462 **NUMBER** _____

MOTION: _____

Fosten

NAME	AYE	NO
REP. BEN COHEN, VICE-CHAIRMAN		✓
REP. ED DOLEZAL		✓
REP. JIM ELLIOTT		✓
REP. ORVAL ELLISON		✓
REP. RUSSELL FAGG Pr.	✓	
REP. MIKE FOSTER	✓	
REP. BOB GILBERT Pr	✓	
REP. MARIAN HANSON	✓	
REP. DAVID HOFFMAN	—	
REP. JIM MADISON		✓
REP. ED MCCAFFREE		✓
REP. BEA MCCARTHY		✓
REP. TOM NELSON	✓	
REP. MARK O'KEEFE		✓
REP. BOB RANEY P		✓
REP. BOB REAM, VICE-CHAIRMAN		✓
REP. TED SCHYE		✓
REP. BARRY "SPOOK" STANG		✓
REP. FRED THOMAS	✓	
REP. DAVE WANZENRIED P		✓
REP. DAN HARRINGTON, CHAIRMAN		✓
TOTAL		

6:14

HOUSE OF REPRESENTATIVES

1 of 2

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB151

DATE 2/4/91 SPONSOR(S) Sen. Eck

PLEASE PRINT **PLEASE PRINT** **PLEASE PRINT**

NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
Charles R. Brooks	MT Ret'l Ass'n	SB151	✓	
James Tutwiler	MT Chamber Com		✓	
Rep. Bunny Bouchard				✓
Doug Kelley	Businessman	151	✓	
Steve Doherty	Stockgrowers	151	✓	
Dennis Burr	MT Taxpayers Assoc	151	✓	
Stuart Doggett	MT Innkeepers MT Manufactured Housing Ass'n	151	✓	
Riley Johnson	NFIB	151	X	
Joe Roberts	Personal Leasing	151	X	
Diane Sands	MT Women's Lobby	151		✓
Laurie Shadoan	Bozeman Chamber	151	X	
John Ortwein	MT Catholic Conf	151		X
Kate Cholewa	MT Women's Lobby	151		✓

PLEASE LEAVE PREPARED TESTIMONY WITH SECRETARY. WITNESS STATEMENT FORMS ARE AVAILABLE IF YOU CARE TO SUBMIT WRITTEN TESTIMONY.

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB 151

DATE 4-5-91 SPONSOR(S) Eck

PLEASE PRINT PLEASE PRINT PLEASE PRINT

NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
Paulette Kohman	MT Council for Mat & Child Health	SB 151		✓
Lorraine Gillies	MT Farm Bureau		✓	
Tom Hodgson	Mtn Ins Assoc. Am.	SB 151	✓	
J. Loendorf	MMA	SB 151		✓

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB299

DATE 4/4/91 SPONSOR(S) Sen. Halligan

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NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
Lloyd Damaha	Lawyer-CPA tax comm.			X

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB 375

DATE 4/4/91 SPONSOR(S) Sen. Brown

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NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
John J McNaught	STAB		X	

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Taxation COMMITTEE BILL NO. SB333

DATE 4/4/91 SPONSOR(S) Sen. Gage

PLEASE PRINT **PLEASE PRINT** **PLEASE PRINT**

NAME AND ~~ADDRESS~~	REPRESENTING	BILL	OPPOSE	SUPPORT
David Hunter	Self and Jim Wylder	amend		
Tim Wylder	myself	amend		
Jeff Miller	Dept of Rev	SB333		✓
Tom Hannon	Mt Soc of CPAs			✓
Mary Carlson CPA	Self -	Support DOR Amendment		
Mark Russell	MT Soc. of CPAs	SB333		✓

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HOUSE OF REPRESENTATIVES

VISITOR'S REGISTER

Session COMMITTEE BILL NO. SB 177

DATE 4/4/91 SPONSOR(S) Sen. Mazurek

PLEASE PRINT **PLEASE PRINT** **PLEASE PRINT**

NAME AND ADDRESS	REPRESENTING	BILL	OPPOSE	SUPPORT
Jeff Smith	Dept of Rev.	SB 77		✓

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