MINUTES

MONTANA HOUSE OF REPRESENTATIVES
52nd LEGISLATURE - REGULAR SESSION

COMMITTEE ON INCOME/SEVERANCE TAX

Call to Order: By BOB REAM, CHAIR, on April 8, 1991, at 9:30 a.m.

ROLL CALL

Members Present:
- Rep. Dan Harrington, Chairman (D)
- Rep. Bob Ream, Vice-Chairman (D)
- Rep. Jim Elliott (D)
- Rep. Mike Foster (R)
- Rep. Bob Gilbert (R)
- Rep. Jim Madison (D)
- Rep. Bea McCarthy (D)
- Rep. Tom Nelson (R)
- Rep. Bob Raney (D)
- Rep. Barry Stang (D)

Members Absent: Rep. M. Hanson (R)

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

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

Subcommittee Discussion on SB 333

Motion: **REP. STANG RECOMMENDED THAT SB 333 BE CONCURRED IN.**

Informational Testimony:

Jeff Miller, Department of Revenue, explained SB 333 and the proposed amendments. He stated SB 333 addressed the Subchapter S. corporation filing status for federal purposes. It will put Montana into step with 40 other states. The amendments address the transitional issue. If somebody who had elected the exception and is now, for Montana purposes, being taxed as a regular corporation instead of on the individual level, are grandfathered under the amendments. Those in compliance with the law, and in the exemption status, will be able to preserve it as long as they meet the requirements of the people paying taxes at a corporate level.

Discussion:

REP. STANG asked **Ward Shanahan, Lobbyist,** if the amendments addressed his concerns. **Mr. Shanahan** said no. He stated that his client, **Timothy Wylder, Attorney,** had a proposed amendment that applied to his situation. **Mr. Shanahan** said there were people who were investing in corporations outside the state. There was no way Montana could tax the corporation, but the people who invested in the corporation could be taxed on income they received by the corporation.

Motion/Vote: **REP. McCARTHY** moved the amendments proposed by DOR. Motion carried unanimously.

Informational Testimony:

Timothy Wylder explained his proposed amendment. **EXHIBIT 1.** He stated, before 1987, he had invested in an S. corporation outside the state and asked the DOR if his reading of the statutes concerning S. corporations was correct. The DOR said his reading was correct. The DOR should be held in its advise to the taxpayer. There is no private letter ruling process at the DOR. He is asking for five years to revise his tax plan based on the change in the law.

Jeff Miller, DOR, said **Mr. Wylder** is talking about one isolated case. SB 333, if enacted, will hold back this exception from existing Sub S. corporations in Montana; and put everyone on the same footing as **Mr. Wylder** and all others investing out of state. This bill will indirectly address **Mr. Wylder's** concerns. The exception now in existence would not apply to nonresidence. **Mr. Wylder** is trying to mitigate his concerns before the committee, and this not an appropriate vehicle. The DOR has offered to stipulate to a agreed statement of facts and go directly for an interlocutory judgement. The DOR is opposed to the amendment.

Discussion:

REP. REAM asked **Jeff Miller** if there was a analogy in other forms of out of state income. **Mr. Miller** stated the out of state income mechanism is dealt with through credits. If another state were to assert jurisdiction over any Montana investors, they would be taxed on their undistributed earnings. There is an advantage to being in a Sub S. It's taxed at the individual level and moves to the corporate. The investor would report all undistributed income in that state, and the DOR would allow them credit. **Mr. Wylder** said he was not proposing the DOR change its litigation procedure just that they live up to the advise they gave him.

REP. REAM asked **Geralyn Driscoll, DOR,** if, under the proposed amendment, it's called a transition rule and no longer takes affect. **Ms. Driscoll** said she would not call it a transition rule. A transition rule is one that is in affect for a few years and then goes out of affect. This amendment is more of a grandfather clause. **Mr. Wylder's** concern are more properly handled in the litigation format because it is a dispute between an individual taxpayer and the DOR. **REP. REAM** asked if **Mr. Wylder's** amendment were to pass, would it affect the litigation that is currently going on. **Ms. Driscoll** said no. The DOR would argue substantial evidence. The taxpayer has no reason to rely on this. The DOR must treat like taxpayers in a like manner. If the state takes the loses from an investor in an out of state Sub S. corporation, those loses have reduced their income. It follows an equity to other taxpayers who have income from out of state Sub. S. corporation.

REP. STANG asked **Jeff Miller** if the bill passed with the DOR amendments, minus the grandfather people, will it bring the Sub. S. into line with every resident no matter where they earn their income. **Mr. Miller** said yes. **REP. NELSON** said the taxpayer is subject to the jurisdiction of the other state also. If there was income that came from the Sub. S. corporation, they would pay income tax in that state which, in turn, would get a credit from Montana. He did not see an inequity.

Motion/Vote: **REP. STANG RECOMMENDED A SUBSTITUTE MOTION THAT SB 333 BE CONCURRED IN AS AMENDED.** Motion passed unanimously.

Information Testimony:

REP. REAM told **Timothy Wylder** that his amendment could be taken and discussed in the full committee even though the subcommittee did not take action on it.

Subcommittee Discussion on SB 226

REP. REAM said that SB 226 was a retirement exemption bill introduced by **SEN. HARP**. There are amendments presented by DOR.

Motion: **REP. STANG RECOMMENDED THAT SB 226 BE CONCURRED IN.**

Informational Testimony:

Jeff Miller, DOR, explained the amendments. **EXHIBIT 2** He stated that the amendments were consistent with all other amendments the DOR has tried to put on all pension bills that have been introduced. They bring forward a definition section. Under current law, these terms have not been defined. As a result, the DOR has gotten into a number of disputes with regard to people his age and younger pulling income from an IRA, saying that it is a retirement benefit. The DOR is saying it isn't. The amendments try to lay out what a pension and annuity income is.

Motion: **REP. ELLIOTT** moved the DOR amendments. Motion carried unanimously.

Discussion:

REP. RANEY asked if language was put in that is consistent with other states language and is it an accepted definition of pension. **Mr. Miller** said yes. It does not deal with the premature withdrawal of an IRA because it is not retirement income. It defines the conventional pension plan and annuities. **REP. RANEY** asked who is not going to like this definition. **Mr. Miller** said it would not reach those people who provide for their retirement by selling their businesses. **REP. RANEY** said neither the bill nor the amendment will provide for the $3,600 exemption for those people who provided for their own pensions. **Mr. Miller** said that was correct. It is not provided for in current law and not provided for in this bill.

REP. McCARTHY asked **Mr. Miller** to elaborate on lump-sum distribution. He said currently it is a separate tax calculation at the federal level. It is not included in the federal tax liability. A separate adjustment must be made to pick it up in the Montana Code.

REP. NELSON asked if a private person, self-employed, buying an annuity from an insurance company not qualifying it as an IRA, that annuity wouldn't be included as annuity income. **Mr. Miller** said they could take the $3,600 exclusion. **REP. STANG** asked if there was any state that considers as retirement income those people who sell their businesses for retirement purposes. **Mr. Miller** said not to his knowledge. To define retirement income, you would have to give everyone an exclusion.

Informational Testimony:

REP. REAM said there were other proposed amendments. SB 226 deals with a difficult problem. Forty two percent of Montana retirees get no pension income so this bill has no affect on them. We have a $3,600 exemption that would apply to the 58% remaining. The data from the DOR says that of the 58% retirees, 20,000 people have retirement from private pension plans; 12,000 federal retirement pensions; and 11,000 with state retirement income. It would bring the federal retirees back to where they were two years ago, bring state retirees to the $3,600 exemption, and the bill also includes a "make whole" provision for state employees. It has no affect on private pension or the 42% of retired people who have no pension. It would affect state and federal retirement incomes.

Discussion:

REP. ELLIOTT asked **David Senn, Montana Teacher's Retirement Association,** if he could address the mechanism for paying out the retirement benefits. He asked if it was the intent in the language of the bill to take the 2% "make whole" into account. **Mr. Senn** said retirees receive different percentages based on the retirement systems. We are attempting to make them whole as a group. **REP. ELLIOTT** said that the 2%, even with the $3,600 exclusion, will not be a sufficient amount to make these various systems whole.

Motion: **REP. ELLIOTT** moved to further amend SB 226. **EXHIBIT 3** He said the amendments would change the 2% to 2 1/2% and would specify where the money would come from. The General Fund is benefiting from the tax and should be the source for the money needed to implement this.

Discussion:

REP. McCARTHY asked **Dave Senn** if the 2 1/2% is necessary because Section 4 takes care of teacher's retirement. **Mr. Senn** said the 2% total benefit is for all eight public retirements systems in the state. We would be taking 2 1/2% from the funding source and distributing it to the boards.

REP. REAM said in the fiscal note states that the impact of the bill, because they are taxing federal and state employees, raises $21.9 million dollars over the biennium. Part 3, the 2%, returns to state retirees 2.67 and 2.98 or $5.6 million over the biennium. The affect of the amendment would increase that by $1.4 million.

Informational Testimony:

REP. O'KEEFE gave the subcommittee an alternative retirement income exclusion levels and projected costs to "keep whole" percentage benefits at 1/2% increments. **EXHIBIT 4**
The committee has 7 options, (1) is the "keep whole" bill with the $3,600 exemption; (2) is to except the bill as is; (3) is to raise the limits and keep no one whole across the board; (4) is raise or lower the limits and keep state employees whole at a different level; (5) is to tax all retirement income; (6) is to tax no retirement income; or (7) is to leave the $3,600 exemption in and keep the state and public employees whole with a large public input on the retirement income. Option #7 has amendments that raises the "keep whole" provisions from 2% to 3.35%. This will cost the General Fund about $4 million dollars less over the biennium than straight funding by lowering the unfunded liability in the PERS system by $2 million dollars, but require the employers of the public employees to pay 3/4% additionally into the retirement funds. It puts the burden on the government entity that is employing the people whether it be state government or county school districts.

Discussion:

REP. ELLIOTT said option #7 would be kinder to the General Fund; but all the money picked up is flowing into the General Fund. The benefit accrues to the General Fund and none of the benefit accrues to the employers. He does not think it is fair for the employer to pay more without them getting the benefits. The employers are the people who are under the restrictions of I-105, and it would increase their costs. The price is to high. **REP. O'KEEFE** said he was not advocating option #7, just explaining the options the subcommittee had. **REP. REAM** said people who are already retired would be funded under the amendments. For employees not retired, it would increase the employer contribution for future retirement. **REP. McCARTHY** said the local governments would not be getting the relief from it the General Fund would.

REP. GILBERT said any increases to "make whole" better is more tax burden placed on the citizens of Montana. The easiest way to do "make whole" would be to tax everyone and go to a $9,000 exclusion. It will eliminate all state employees. **REP. RANEY** said the he asked the DOR to run figures on the federal employees. Eight thousand dollars would be the figure needed if the committee didn't want to do any "making whole". It would cover most people. **REP. GILBERT** asked **Jeff Miller** if going to the flat fee of $8,000 would give equal protection to the private retirees. **Mr. Miller** said yes. **REP. REAM** said when you talk about private retirees, you are talking about those with a pension plan. **REP. GILBERT** said he was talking about everyone who has a retirement income. **REP. McCARTHY** said that in order to get to where **REP. GILBERT** wants to go is to put an age stipulation on it. There is no statutory definition of retirement age.

REP. RANEY asked how much money did the General Fund lose by dropping the federal employees. **REP. O'KEEFE** said 15.8 million dollars and that is increasing every year. **REP. McCARTHY** said the lawsuit said that federal employees had to be treated like everyone else. **REP. ELLIOTT** said the issue of the amendment is not the $3,600 exemption. The issue is the raise in rate from 2% to 2 1/2% and that the funding is taken from the General Fund. They will have amendments in the full committee that address the exemption issue and called for the question.

Vote: Motion to amend carried 7 to 2 with **REPS. NELSON** and **GILBERT** voting no and **REP. M. HANSON** absent.

Motion/Vote: **REP. ELLIOTT MADE A SUBSTITUTE RECOMMENDATION THAT SB 226 BE CONCURRED IN AS AMENDED.** Motion carried 8 to 1 with **REP. GILBERT** voting no and **REP. M. HANSON** absent.

ADJOURNMENT

Adjournment: 10:30 a.m.

Bob Ream

BOB REAM, Chair

Lois O'Connor

LOIS O'CONNOR, Secretary

BR/lo

EXHIBIT 1 p.1
DATE 4-8-91
HB SB 333

House Committee on Taxation
Income Tax Subcommittee
April 8, 1991

MCA 15-30-111(3) provides as follows:

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 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.

MCA 15-30-111(3) applies to which cases?

		S CORPORATION DOMICILE	
		MONTANA	NON-MONTANA
SHAREHOLDER	MT	DOR YES TJW YES	DOR '87 YES DOR '88 NO TJW YES
SHAREHOLDER	NON MT	DOR YES TJW YES	NO TAX

Prepared by Timothy J. Wylder, Attorney at Law

EXHIBIT 1 p.2
DATE 4-9-91
HB SB 333

AMENDMENT TO SENATE BILL 333

April 8, 1991

NEW SECTION. **Transition Rule for Shareholders of Certain Foreign S Corporations.** With regard to resident shareholders of foreign S Corporations not doing business in Montana, if the taxpayer establishes by substantial evidence that the taxpayer relied on Department of Revenue advice that Section 15-30-111(3), MCA applied to such taxpayer, then that Section shall continue to apply to such taxpayer for all tax years beginning on or before December 31, 1996.

EXHIBIT 2
DATE 4-8-91
HB SB 226

Amendments to Senate Bill No. 226
Third Reading Copy

Requested by DOR
For the Committee on Taxation

Prepared by Lee Heiman
April 8, 1991

1. Title, line 14.
Following: "~~15-30-101,~~"
Insert: "15-30-101,"

2. Page 3.
Following: line 7
Insert:"Section 1. Section 15-30-101, MCA, is amended to read:

"**15-30-101. Definitions.** For the purpose of this chapter, unless otherwise required by the context, the following definitions apply:

(1) "Base year structure" means the following elements of the income tax structure:

(a) the tax brackets established in 15-30-103, but unadjusted by subsection (2) of 15-30-103, in effect on June 30 of the taxable year;

(b) the exemptions contained in 15-30-112, but unadjusted by subsections (7) and (8) of 15-30-112, in effect on June 30 of the taxable year;

(c) the maximum standard deduction provided in 15-30-122, but unadjusted by subsection (2) of 15-30-122, in effect on June 30 of the taxable year.

(2) "Consumer price index" means the consumer price index, United States city average, for all items, using the 1967 base of 100 as published by the bureau of labor statistics of the U.S. department of labor.

(3) "Department" means the department of revenue.

(4) "Dividend" means any distribution made by a corporation out of its earnings or profits to its shareholders or members, whether in cash or in other property or in stock of the corporation, other than stock dividends as herein defined. "Stock dividends" means new stock issued, for surplus or profits capitalized, to shareholders in proportion to their previous holdings.

(5) "Fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporate, acting in any fiduciary capacity for any person, trust, or estate.

(6) "Foreign country" or "foreign government" means any jurisdiction other than the one embraced within the United States, its territories and possessions.

(7) "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, excluding unemployment compensation included in federal gross income under the provisions of section 85 of the Internal Revenue Code of 1954 as amended.

EXHIBIT 2
DATE 4-8-91
HB SB226

(8) "Inflation factor" means a number determined for each taxable year by dividing the consumer price index for June of the taxable year by the consumer price index for June, 1980.

(9) "Information agents" includes all individuals, corporations, associations, and partnerships, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, brokers, real estate brokers, employers, and all officers and employees of the state or of any municipal corporation or political subdivision of the state, having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income with respect to which any person or fiduciary is taxable under this chapter.

(10) "Knowingly" is as defined in 45-2-101.

(11) "Net income" means the adjusted gross income of a taxpayer less the deductions allowed by this chapter.

(12) "Paid", for the purposes of the deductions and credits under this chapter, means paid or accrued or paid or incurred, and the terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the taxable income is computed under this chapter.

(13) "Pension and annuity income" means:

(a) systematic payments of a definitely determinable amount from a qualified pension plan, as that term is used in section 401 of the Internal Revenue Code, or systematic payments received as the result of contributions made to a qualified pension plan that are paid to the recipient or recipient's beneficiary upon the cessation of employment;

(b) payments received as the result of past service and cessation of employment in the uniformed services of the United States;

(c) lump-sum distributions from pension or profitsharing plans to the extent that the distributions are included in federal adjusted gross income;

(d) distributions from individual retirement, deferred compensation, and self-employed retirement plans recognized under sections 401 through 408 of the Internal Revenue Code to the extent that the distributions are not considered to be premature distributions for federal income tax purposes; or

(e) amounts after cessation of regular employment received from fully matured, privately purchased annuity contracts.

~~(13)~~ (14) "Purposely" is as defined in 45-2-101.

~~(14)~~ (15) "Received", for the purpose of computation of taxable income under this chapter, means received or accrued and the term "received or accrued" shall be construed according to the method of accounting upon the basis of which the taxable income is computed under this chapter.

~~(15)~~ (16) "Resident" applies only to natural persons and includes, for the purpose of determining liability to the tax imposed by this chapter with reference to the income of any taxable year, any person domiciled in the state of Montana and any other person who maintains a permanent place of abode within the state even though temporarily absent from the state and has not established a residence elsewhere.

~~(16)~~ (17) "Taxable income" means the adjusted gross income of a taxpayer less the deductions and exemptions provided for in this chapter.

~~(17)~~ (18) "Taxable year" means the taxpayer's taxable year for federal income tax purposes.

~~(18)~~ (19) "Taxpayer" includes any person or fiduciary, resident or nonresident, subject to a tax imposed by this chapter and does not include corporations.""

Renumber: subsequent sections

3. Page 4, lines 13 through 18.
Strike: "all" on line 13 through "system" on line 18
Insert: "the first $3,600 of all pension and annuity income received as defined in 15-30-101"

4. Page 8, lines 14 through 22.
Strike: subsection (8) in its entirety

5. Page 11, lines 6 through 11.
Strike: subsection (h) in its entirety
Renumber: subsequent subsection

6. Page 13, lines 3 through 11.
Strike: subsection (6) in its entirety

7. Page 13, line 17.
Strike: "4"
Insert: "5"

8. Page 22, line 12.
Strike: "3 and"
Following: "4"
Insert: "and 5"

9. Page 22, line 14.
Strike: "3 and"
Following: "4"
Insert: "and 5"

EXHIBIT 3
DATE 4-8-91
HB SB 226

Amendments to Senate Bill No. 226
Third Reading Copy

Requested by Rep. Ream
For the Committee on Taxation

Prepared by Lee Heiman
April 8, 1991

1. Title, line 14.
Following: "RESIDENTS;"
Insert: "TO PROVIDE A STATUTORY APPROPRIATION FOR ADJUSTMENT PAYMENTS;"

2. Title, line 15.
Following: "15-30-136,"
Insert: "17-7-502,"

3. Page 13, line 13.
Following: "deposit"
Insert: "-- statutory appropriation"
Strike: "allocated"
Insert: "statutorily appropriated, as provided in 17-7-502, from the general fund"

4. Page 13, line 21.
Strike: "2%"
Insert: "2 1/2%"

5. Page 22.
Following: line 4
Insert: "**Section 17.** Section 17-7-502, MCA, is amended to read:

"**17-7-502. Statutory appropriations -- definition -- requisites for validity.** (1) A statutory appropriation is an appropriation made by permanent law that authorizes spending by a state agency without the need for a biennial legislative appropriation or budget amendment.

(2) Except as provided in subsection (4), to be effective, a statutory appropriation must comply with both of the following provisions:

(a) The law containing the statutory authority must be listed in subsection (3).

(b) The law or portion of the law making a statutory appropriation must specifically state that a statutory appropriation is made as provided in this section.

(3) The following laws are the only laws containing statutory appropriations: 2-9-202; 2-17-105; 2-18-812; 10-3-203; 10-3-312; 10-3-314; 10-4-301; 13-37-304; 15-1-111; 15-25-123; 15-31-702; 15-36-112; 15-37-117; 15-65-121; 15-70-101; 16-1-404; 16-1-410; 16-1-411; 17-3-212; 17-5-404; 17-5-424; 17-5-804; 19-8-504; 19-9-702; 19-9-1007; 19-10-205; 19-10-305; 19-10-506; 19-11-512; 19-11-513; 19-11-606; 19-12-301; 19-13-604; 20-6-406; 20-8-111; 20-9-361; 23-5-306; 23-5-409; 23-5-610; 23-5-612; 23-5-1016; 23-5-1027; 27-12-206;

EXHIBIT 4 p.1
DATE 4-8-91
HB SB226

EXHIBIT 4 p.2
DATE 4-8-91
HB SB-226

' ALTERNATIVE RETIREMENT INCOME
ET EXCLUSION LEVELS
millions of dollars)

FY92	FY93	Biennium
18.91	20.80	39.71
10.43	11.47	21.90
9.70	10.67	20.38
8.89	9.78	18.68
8.19	9.01	17.20
6.81	7.49	14.31
5.61	6.18	11.79
4.55	5.00	9.55
3.36	3.99	7.62
2.82	3.10	5.92
2.14	2.36	4.50
1.55	1.70	3.25

ATE/LOCAL GOVERNMENT
NTAGES OF BENEFITS
s)

FY93	Biennium
1.49	2.83
2.24	4.25
2.98	5.65
3.73	7.07
4.47	8.48
5.22	9.90
5.96	11.31
6.71	12.73
7.45	14.13
8.20	15.55
8.94	16.96