MINUTES

MONTANA SENATE
52nd LEGISLATURE - REGULAR SESSION

COMMITTEE ON TAXATION

Call to Order: By Senator Dorothy Eck, on February 14, 1991, at 8:05 a.m.

ROLL CALL

Members Present:

Mike Halligan, Chairman (D)
Dorothy Eck, Vice Chairman (D)
Robert Brown (R)
Steve Doherty (D)
Delwyn Gage (R)
John Harp (R)
Francis Koehnke (D)
Gene Thayer (R)
Thomas Towe (D)
Van Valkenburg (D)
Bill Yellowtail (D)

Members Excused: NONE.

Staff Present: Jeff Martin (Legislative Council).

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

Announcements/Discussion: NONE.

HEARING ON SENATE BILL 278

Presentation and Opening Statement by Sponsor:

Senator Delwyn Gage told the Committee Senate Bill 278 repeals the express company license tax and sleeping car license tax with 18 sections of MCA being removed. He explained there would be no effect to the budget.

Proponents' Testimony:

Jeff Miller, Administrator of the Income and Miscellaneous Tax Division told the Committee the two taxes had no tax payers presently. The express company tax was enacted in 1917 as a 4% gross receipts tax. He explained it had been considered for repeal in 1977, but concerns were expressed regarding companies doing business in Montana that could be considered express companies. Administrative proceeding before the department found

the company in question did not meet the definition of an express company. The decision was appealed to the State Tax Appeal Board (STAB). STAB concluded the company did not meet the definition. Even though the company was a common carrier, they did not operate at regular and scheduled times nor were they operating over fixed and regular routes. He told the last taxpayer of the sleeping car license tax was Amtrak. He explained Amtrak became a quasi-federal agency in the early 1970s. In 1978 Congress specifically exempted Amtrak from state and local income tax.

Opponents' Testimony:

NONE.

Questions From Committee Members:

Senator Towe asked Mr. Miller the definition of an express company. Mr. Miller explained STAB relied on the definition as one of all of the following: Common carrier operating at regular and scheduled times over fixed and regular routes; carrying valuable packages in a speedy manner.

Senator Towe asked if this covered any of the air carriers. Mr. Miller told the Committee these carriers are not "scheduled".

Senator Eck asked what the tax had been. Mr. Miller explained it was 4% of the gross receipts on intra-state businesses, individual and corporate express companies. He told the Committee while the tax was being collected in the 1970s it was about $700 a year.

Closing by Sponsor:

Senator Gage closed on Senate Bill 278.

EXECUTIVE ACTION ON SENATE BILL 278

Motion:

Senator Thayer moved Senate Bill 278 DO PASS.

Discussion:

NONE.

Amendments, Discussion, and Votes:

NONE.

Recommendation and Vote:

Motion to DO PASS on Senate Bill 278 CARRIED.

HEARING ON SENATE BILL 279

Presentation and Opening Statement by Sponsor:

Senator Bob Brown explained Senate Bill 279 was at the request of the Department of Revenue and prepared by a special advisory committee to the Department of Revenue. He told the Committee the bill is to ensure that the rights, privacy, and property of Montana taxpayers are adequately protected during the process of assessment and collection of taxes administered by the Department of Revenue. He explained most is existing department policy. The bill will put the rights of taxpayers which is generally understood in following those policies, or what already exists in a separate section of the statute. It would facilitate the taxpayers understanding of their tax situation. Included in the bill is the creation of a new office in the department called the Office of Taxpayer Assistance.

Proponents' Testimony:

Dave Woodgerd representing the Montana Department of Revenue told the Committee the concept has been in the department for a couple of years. California enacted a taxpayers bill of rights in about 1988, and since that time approximately another dozen states have adopted one, as well as the federal government. Mr. Woodgerd told the Committee aside from the ethical considerations of treating people fairly, the department wishes to improve relations with the taxpayer by furthering the concept of the taxpayer as a customer. He explained better relations with the taxpayer would bring better voluntary compliance with the tax laws with less administrative problems in collecting the tax.

He explained the committee who worked on the provisions of Senate Bill 279 was comprised of state employees, department of revenue employees, as well as individuals outside the department. Dennis Burr, Gordon Morris from MACO, an internal revenue representative, and a representative from outside counsel who represented taxpayers on a regular basis, served on this committee.

Mr. Woodgerd presented a copy of a brochure from Nebraska for the Committee's perusal. He explained they reviewed what other states had done and singled out what had assisted the taxpayer as well as helping administrative function.

Mr. Woodgerd presented the Committee with a handout which he described. (Exhibit #1)

Dennis Burr representing the Montana Taxpayers Association spoke in favor of Senate Bill 279. He told the Committee in addition to the states adopting a taxpayers bill of rights there are others that have adopted it through rules of the department of revenue. He explained if the bill is passed a brochure would be prepared by the department available to taxpayers.

James Tutwiler representing the Montana Chamber of Commerce spoke in support of Senate Bill 279.

Tom Harrison of the Montana Society of Certified Public Accounts told the Committee the society, as well as having input into the drafting of the legislation, endorses Senate Bill 279.

Tom Hofgood representing the Montana Association of Realtor spoke in favor of Senate Bill 279. Although Mr. Hofgood did not sign the Visitor's Register his testimony is noted. He told the Committee tax reform is an item on the agenda for the association this session.

Opponents' Testimony:

NONE.

Questions From Committee Members:

Senator Towe told the Committee Senate Bill 279 is commendable. He asked Mr. Woodgerd about Page 3, Lines 2 through 6, where it speaks of the taxpayer having the right, at the discretion of the department. Senator Towe asked if the intent is the taxpayer is to have the right, whenever there is a request, unless the department feels there is not reason for the right to be exercised. Mr. Woodgerd explained the provision had been debated in the committee and within the department. He explained taxpayers are now allowed to make installment payments after the department is satisfied there is no other way the taxpayer can afford to pay the taxes. He explained the installment basis requires additional administrative functions, and is avoided except as a last resort. He told the Committee the language in Lines 2 through 6, Page 3 is saying that.

Senator Towe asked Mr. Woodgerd about Page 4, Line 8. Senator Towe expressed hope that the department would follow that. Senator Towe explained with a step in the right direction and a "good gesture" on the part of the department regarding the rights of the taxpayer, the "worst travesty of all is still the warrant of distraint". He commented that other departments have to give notice in advance, with an opportunity to respond. Mr. Woodgerd told the Committee the only time the department can do that is in an emergency situation.

Senator Harp asked Mr. Woodgerd about Section 3. Office of taxpayer assistance. He asked if an existing FTE would fill this position or if it would require additional staff. Mr. Woodgerd explained there is an existing position in the directors office.

Senator Halligan pointed out considerable duties that are required of this position. He asked Mr. Woodgerd why the position he is speaking of exists now. Mr. Woodgerd explained his understanding is the position is currently vacant and has been scheduled for cut, but is in the current level budget. He explained it would be a full time position and the department's intention is to hire someone full time.

Senator Halligan commented on the program with the auditors for monitoring agencies for compliance. He pointed out this position appears to be what the auditors would do. In certain instances there appears to be duplication, i.e., compiling reports, determining the number and types of complaints, determining the effectiveness of the department's handling of complaints.

Senator Eck asked Dave Woodgerd if the counties who participated in the study are planning something similar at the county level. Mr. Woodgerd told the Committee he could not comment, the issue did not come up.

Closing by Sponsor:

Senator Brown closed on Senate Bill 279.

EXECUTIVE ACTION ON SENATE BILL 279

Motion:

Senator Harp moved DO PASS on Senate Bill 279.

Discussion:

NONE.

Amendments, Discussion, and Votes:

NONE.

Recommendation and Vote:

Motion to DO PASS CARRIES.

HEARING ON SENATE BILL 280

Presentation and Opening Statement by Sponsor:

Senator Brown told the Committee Senate Bill 280 is at the request of the Department of Revenue. He explained it will standardize the administration and collection of eight miscellaneous taxes and fees as an attempt to reduce administrative costs and facilitate taxpayer compliance.

Proponents' Testimony:

Jeff Miller, Administrator of the Income Tax Division told the Committee the bill would standardize and make more understandable to various requirements. He told the Committee there is a common population of taxpayers paying these taxes. They are faced with varying regulations in requirements depending on whether they are paying a corporate income tax or withholding

tax or similar tax. He explained an exhibit (Exhibit #2) he prepared to further explain Senate Bill 280.

Opponents' Testimony:

NONE.

Questions From Committee Members:

Senator Gage asked Jeff Miller if there was an estimate as to the delinquencies were. Mr. Miller explained there is approximately $8400 in delinquent accommodation tax, and a large telephone license tax is being protested. The balance he explained is not a serious issue of delinquencies. He estimated in aggregate and excluding the $84,000 for accommodation and the telephone at $4 million, delinquencies would be less than $100,000. Senator Gage what the nature of the telephone license tax protest was. Mr. Miller explained an outstanding telephone tax dispute against AT&T relative to back years, and relative to the question of whether or not the revenues the derived from providing equipment was part of their telephone business. The case is currently before STAB, and is expected to proceed through the appeals process.

Senator Harp asked Mr. Miller about the bed tax. Mr. Miller explained the accommodations tax due date now is the 30th day following the close of the quarter with withholding the last day of the month. Since it generally viewed as filing the last day of the month, penalties have been assessed and causes an unpleasant situation.

Senator Towe asked if it was the same language in each case. Mr. Miller explained they were attempting to do so. He explained where penalties and interest were cited the language was made uniform; where the law was silent on the issue language was offered.

Senator Towe asked about credit and refund. Mr. Miller told the Committee a person is entitled to a credit or refund if claim is made within five years of the due date of filing the return. The credit or refund would first be applied to any underpayment, the balance refunded with interest at the same rate the department charges (1% per month).

Closing by Sponsor:

Senator Brown closed on Senate Bill 280.

HEARING ON SENATE BILL 333

Presentation and Opening Statement by Sponsor:

Senator Delwyn Gage explained Senate Bill 333 would give corporations outside of Montana and operating in Montana the same

treatment for Sub S election purposes as Montana corporations. He explained if the corporation elects Sub S status for federal they will automatically elected Sub S status for state. The reasoning is not only standardization, but there are some large taxpayers in Montana who have elected federal status on out-of-state corporations. They are avoiding Montana tax. Another concern is when having a different election for Montana opposed to the federal there is a requirement of two accounts for each of the stockholders unless all the income is distributed.

Proponents' Testimony:

Jeff Miller explained Senate Bill 333 was attempting three major revisions. Corporations and shareholders would be required to be bound by the federal election. Under current law a federal Sub S can elect out for Montana purposes entitling the shareholders to an exception; instead of reporting their federal adjusted gross income they are taxed only an actual distributions. The same election is not available to out-of-state residents creating confusion. With SB 333 the federal election will control whether resident or non-resident; whether Sub S is operating in Montana or out-of-state. Further, filing and perfection is simplified for state purposes. Mr. Miller prepared an exhibit for clarification. (Exhibit #3)

Tom Harrison representing the Montana Society of Certified Public Accountants spoke in favor of Senate Bill 333. He told the Committee the society endorsed the legislation "solely on and limited to the basis" of simplification. He explained the members of their organization did not receive information relating to the bill until February 13. He felt there was not ample opportunity to determine any practical problems the bill could present. He told the Committee that would be available if necessary.

Opponents' Testimony:

Tim Wylder, attorney from Great Falls, Montana spoke in opposition to Senate Bill 333. He told the Committee he was appearing on his on behalf, as a taxpayer and as a tax practioner. He stated SB 333 had merits in simplification and clarification of language in procedure in election, but the substance of the rule is misplaced. He explained the revenue issues are misaddressed. He said the fact one can exclude from the Montana tax base federal adjusted gross income and then take a deduction from state income for the total amount of federal taxes paid, creates a problem. In his opinion it is not simply clarification. The rule currently was clear that individuals are not taxed on undistributed income from a foreign corporation. In 1987 several taxpayers had loses and persuaded the department to allow them to use these loses. He told the Committee he looked into this issue in depth when he had an opportunity to invest in foreign S corporation. Through reading the statute it was clear that as such time the corporation distributed its

income it was not taxable in Montana; when it was distributed it was taxable. He and his accountant asked the department if their understanding was correct, and were told at they were. He told the Committee aside from the revenue issues which he agrees needs to addressed, "this issue has been up in the air for them all along". He said it was his understanding this bill took the opposite position when requested.

Mr. Wylder raised another issue with regards to Senate Bill 61 which limits the ability to take advantage of losses to losses generated out of Montana activity. He told the Committee it was not fair to change the rule where one cannot take advantage of out-of-state losses but is taxed on out-of-state gains which are not distributed.

Mr. Wylder proposed amendments to Senate Bill 333 which would address the concerns of the department without changing the basic rule which he feels has been clear. (Exhibit #5) He told the Committee with the amendments he could support the bill.

Questions From Committee Members:

Senator Towe asked Mr. Miller about Senate Bill 61. Mr. Miller explained it was in regards to federal taxes on income not subject to Montana tax, especially with the calculation of "at operating loss". To pull out federal taxes associated to income not subject to Montana as it relates to the Sub S distributions may be fairly simple, but federal taxes associated to US interest, other income such as Indian income or military pay taxed at federal but not at state level would not sort out as simply.

Senator Towe asked about Mr. Wylder's point of disallowing the loss but not waiting until the income comes into Montana. Mr. Miller told the Committee the deductible of federal taxes is only a portion of the problem. Tracking is a problem. The state will not see the return or the K1 that associates to that return or the 1099s because there will no 1099s. A distribution that show on the K1 filed for federal purposes but will not be provided to Montana because the state has no nexus with the corporation. There is no ability to follow that income back into the state.

Senator Towe asked if the corporation with a Montana Stockholder filing under Sub S elsewhere could be required to file a copy of the K1 with Montana. Mr. Miller explained there was no authority to force compliance with a Sub S in another state.

Senator Towe asked if there would be inconsistency in treatment in one way by disallowing the loss by passing SB 333. Mr. Miller explained the loss is not being disallowed under Senate Bill 61. Federal taxes associated or that would create that loss if it is associated income not taxable in the state of

Montana are being disallowed. The loss is still allowable under SB 61.

Senator Towe asked if then "we have disallowed the federal tax as a deduction which was not the same thing as disallowing a loss from the Sub S". Mr. Miller told the Committee that was correct.

Senator Thayer commented it did not seem fair taxpayers should have to pay tax on undistributed income, because it may never be distributed. For instance, what if the Sub S corporation through financial trouble while the tax is being paid for several years, and the income is not distributed.

Mr. Miller explained the unique entity dealt with is one that is chosen not to be taxed on its earnings at the entity level but rather to the individual level. It is not a situation of holding them to a higher standard of tax. The earnings from that activity are going to be taxed somewhere. For federal purposes they are taxed at the individual level; for state purposes they should also be taxed at the state level as earned because there are no tax at the corporate level.

Senator Towe asked Mr. Wylder if in Senate Bill 61 of only the deductibility of federal taxes, for federal purposes, (and in another state very likely as a Sub S corporation) why is it not fair or just to do so in Montana in all instances. Mr. Wylder told the Committee the federal government (assuming residents of Montana or the United States) will receive its tax no matter which state a person is in. He explained that at the state level it makes more sense to wait until distribution.

Senator Towe asked Mr. Wylder if his real concern hurting someone in the change-over. Mr. Wylder explained it is a matter of expectations. What exists now (somewhat limited by Senate Bill 61) with the old rule v. the new rule should not effect revenue in principle. The rule being proposed is losses can be recognized from out-of-state subject to limitations of Senate Bill 61, and the gains must be recognized. He explained the former rule was the opposite. He told the Committee his position the former rule "worked fine". The administration was "not a nightmare". The 1% of taxpayers in the situation had accountants keeping track. He explained taxpayers have made plans based on a well-established rule.

Senator Towe asked Mr. Miller about the point made by Mr. Wylder that taxpayers made investments on the former understanding. Mr. Miller told the Committee there had been a change because an individual came forward asking to include losses. Through an administrative hearing the individual prevailed. Since that time the have proceeded on this basis. If Senate Bill 333 passes an effective date for years after December 31, 1991, would cause the need for transition because there would be no grandfathering. At that point past timing differences

would be reconciled. He admitted investments strategies would be changed.

Senator Towe asked if there would be need for a statutory recognition of the transition. Mr. Miller commented it would not have to be dealt with statutorily. Senate Bill 333 would say for purposes of income tax, all years beginning after December 31, 1991, reporting would be on the same basis as federal.

Ward Shanahan, a Helena attorney told the Committee he was in support of Mr. Wylder's amendment. He commented about a statement from the American Spectator magazine regarding tax policy which says, "the tax policy often does not result in the redistribution of income, it results in the redistribution of taxpayers". He told the Committee he would be available to discuss Mr. Wylder's amendment.

Mr. Wylder told the Committee he was not sure the state would be entitled to tax distributions related to formerly taxed income at the federal level. He said Senate Bill 333 current attributable income would be tracked as the federal level. Therefore if distribution comes from a foreign S corporation there are no mechanics that would recognize it. He explained now the rule is clear, when it comes in it is taxable; but that is not what Senate Bill 333 says.

Senator Towe asked if it were not true there should be a rule to do so. If a rule is promulgated saying any income from a S corporation that has not been taxed because of previous ruling of the department it is now subject to tax as paid.

Closing by Sponsor:

Senator Gage closed on Senate Bill 333.

EXECUTIVE ACTION ON SENATE BILL 115

Motion:

Senator Van Valkenburg moved the amendments on the "gray bill". In addition, he moved striking Section 5 sub (4), and adding to sub 2 a new sub (c) saying "property tax revenue shall be distributed to the local governments based on the situs of the property".

Senator Towe offered a substitute motion to adopt all amendments, with the exception to the proposed addition to the new sub (c). He moved the following language for (c): "Property tax shall be distributed to the county treasurer for county purposes only, unless by agreement, a different distribution is presented within the proposal."

Discussion:

Jeff Martin explained the amendments to the Senate Bill 115 "gray bill" #2.

Senator Halligan told the Committee Alec Hansen and Gordon Morris they explained a municipality could not adopt a tax based on a county resolution as to what the tax would be. Their own election would have to take place simultaneously under their own resolution. He asked Alec Hansen to discuss Sub 4.

Alec Hansen of the Montana League of Cities and Towns told the Committee the amendment preempts cities from having the first election which was not their intent. He explained there would be separate simultaneous elections. If it passed in the municipal election, it would take place in the municipality. If it passed county-wide it would go on in the county. He explained separate simultaneous election (if it is the intent of the county) need to be provided for. He commented if the county does not propose a referendum, or if it fails county-wide, then, and only then, can the city have an election. He told the Committee that was not their intent. The intent is to make it as equal as possible: "a city can do it or a county can do it". He explained this was allowable under existing law. The issue of elections does not need to be dealt with in Senate Bill 115.

Senator Towe asked if Sub 4 should be struck. Mr. Hansen said that was correct.

Senator Harp commented that initial discussions were concerns of "who was going to get in first" and what the effects will be in imposing the tax. He asked if by disallowing Sub 4 the Committee was back to those same questions. Mr. Hansen explained that was so, with the qualification that if a city was to propose a local option tax the county under existing law would have equal right to propose an election on the same issue at the same time. This would be a county election and a city election; both separate; the results would be counted separately; the tax would be imposes accordingly.

Senator Harp asked then if there was a need to authorize a provision dealing with municipalities, and if the counties are already dealt with under existing statute. Mr. Hansen told the Committee that was his assumption.

Senator Thayer posed the question: If there were a county-wide election with the county portion failing and the city going ahead, under Section 2 (with distribution), would any funds be distributed to the county, even though the county voters voted it down? Mr. Hansen said no.

Senator Yellowtail posed a different question: What if in Yellowstone County there is a county election, where the preponderance of the population is in Billings; and the county-

wide issue passes, but Laurel distinctly does not wish to have the tax? Mr. Hansen told the Committee the authority of the political sub-division would be imposed with the tax being levied county-wide.

Senator Halligan asked then if a simultaneous election would have to be held in Laurel, as well as in Billings. Mr. Hansen explained only if Laurel wants to do this. If it is not on the ballot in Laurel and passes in Yellowstone County, it would be imposed on Laurel.

Senator Yellowtail asked what if Laurel puts it on their ballot specifically to express their desire not to have the tax. Mr. Hansen told the Committee if it passes county-wide it would still be imposed on Laurel.

Senator Towe pointed out Laurel would also get the money.

Senator Yellowtail pointed out, for instance, what if Laurel does not need it, or has difficulty competing with the Billings market and without the tax would draw Billings business.

Senator Harp pointed to another example: An election were at the same time, one in Laurel and one in Yellowstone County. He asked if one could impose a sales tax while the other imposed an income tax. Mr. Hansen told the Committee he would hope not. He explained both measures would probably fail, the voters should be trusted in these situations.

Senator Van Valkenburg asked Jeff Martin about the provision on Page 6 providing for distribution of tax imposed county-wide with sub (a) providing for sales tax and sub (b) providing income tax. He asked if there were a reason why no there was not a provision regarding distribution of a property tax. Mr. Martin told the Committee that issue was not addressed specifically.

Senator Van Valkenburg told the Committee he assumed the intent of the local governments would be any property tax would be distributed solely on the situs of the property within the jurisdiction. He explained if there are formulas for sales tax and income tax, the law should be clear as to the intent of the Committee with respect to property tax.

Senator Towe asked what the intent is if a property tax is authorized. Is the intent once the property is collected (i.e., the city votes on it, it is collected in the city on property in the city) would 49% go to the school districts, with a portion of the mills going to the county.

Senator Van Valkenburg said it is not intended to "fill up school coffers".

Senator Halligan asked Gordon Morris if he would comment on property tax distribution.

Mr. Morris explained his first reaction to the bill was why property tax was included. He told the Committee property tax should be distributed based upon situs considerations.

Senator Towe asked that something be included to make the point clear. He explained it would be helpful if a property tax is done, it be done on a basis for a mill levy for a specific purpose.

Senator Halligan asked for language in Sub 4 for striking Sub 4 and allowing the election to occur under existing law. The feel of the meeting was it was not needed.

Senator Gage asked if a section should be included indicating the legislation is outside of I105 restrictions.

Jeff Martin directed the Committee to the first "gray bill". He pointed out attached to it is 15-10-412 that provides for an exemption from I105.

Dennis Burr told the Committee it appears two units of local government can levy property tax. He explained property tax may need to be exempted from the double taxation. There could be an instance in which a city and a county passing the tax, and both should be able to collect.

Alec Hansen explained there is a provision in existing law. He explained Lewis and Clark County used it. The county has the authority at a vote of the people to declare a national emergency and increase their levy. The additional level goes exclusively to the county. He told the Committee if the city wishes to do the same thing it should have to do so separately.

Senator Towe told the Committee the language in SB 115 would suggest double taxation would never be allowed.

Senator Van Valkenburg explained the provision only prohibits double taxation with respect to local option taxes. He commented there was no sense in having a local option tax that would be a county-wide mill covering everything; then let a city put an additional mill over and above the county mill. He told the Committee the intent would be to have a local option tax that would be either solely county-wide or outside the jurisdiction of a municipality with the municipality having the option of its own property tax option.

Senator Van Valkenburg explained all the property within the municipality would pay the property tax with all tax going to the municipality. All the property outside the municipality would pay the tax with it going to the county.

Senator Gage pointed out if the city does not vote to put on a mill, but a county-wide mill is passed; the municipality will part of the county mill if distributed on basis of situs of

property.

Senator Van Valkenburg told the Committee the purpose of the distribution formulas with respect to sales tax and income tax are so there are not separate administrative means. A means is provided by which the municipality can receive its properly proportioned share of the tax.

Steve Bender reminded the Committee that I105 applies to each distinct levy and each taxing jurisdiction. When addressing a county exception to I105 it is a specific mill levy, i.e., a county general fund levy.

Senator Van Valkenburg explained what is being provided is a specific exemption from the I105 limits for the purposes of a local option property tax. He said no exemption to a general fund levy is being provided.

Ann Mary Dussault told the Committee there seem to be three options available under a local option tax all relating to the reason any jurisdiction would propose a local option tax. She explained there could a local option tax proposed by the county only for a county purpose, i.e., a juvenile detention facility. There could be a proposal by a municipality for a municipal proposal only. Or a proposal the cities and counties in the jurisdiction would have to work out through an inter-local agreement, both as to purpose and distribution. She explained the "key" is what the purpose is regardless of the source.

Amendments, Discussion, and Votes:

Senator Towe's substitute motion to amend CARRIED with Senator Yellowtail and Senator Van Valkenburg voting NO.

Recommendation and Vote:

Chairman Halligan told the Committee further executive session on Senate Bill 115 will be held Friday, February 15.

ADJOURNMENT

Adjournment At: 10:00 a.m.

SENATOR MIKE HALLIGAN, Chairman

LINDA CASEY, Secretary

MH/llc

TA021491.SM1

ROLL CALL

SENATE TAXATION COMMITTEE

DATE 2/14/91

___ LEGISLATIVE SESSION ___

NAME	PRESENT	ABSENT	EXCUSED
SEN. HALLIGAN	P		
SEN. ECK	P		
SEN. BROWN	P		
SEN. DOHERTY	P		
SEN. GAGE	P		
SEN. HARP	P		
SEN. KOEHNKE	P		
SEN. THAYER	P		
SEN. TOWE	P		
SEN. VAN VALKENBURG	P		
SEN. YELLOWTAIL	P		

Each day attach to minutes.

SENATE STANDING COMMITTEE REPORT

February 14, 1991

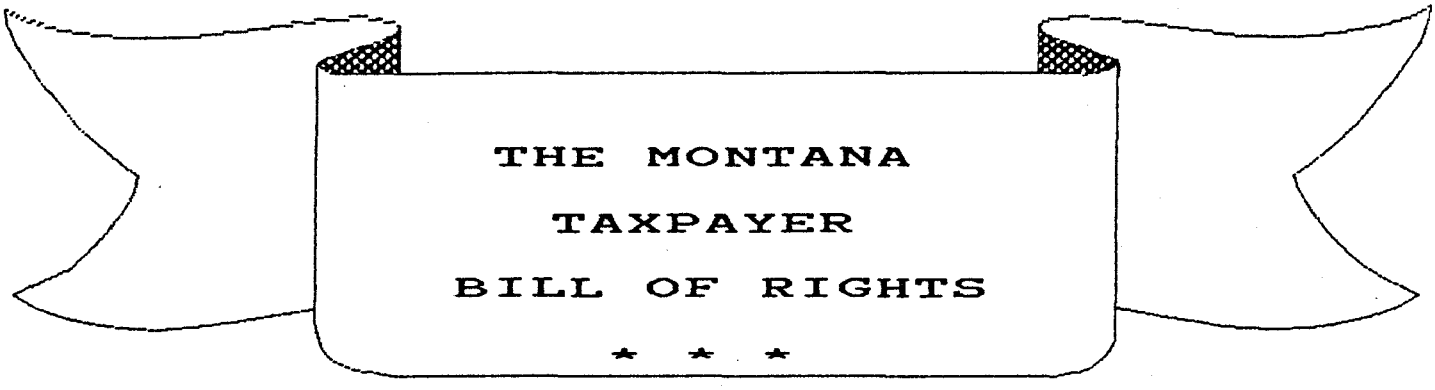
MR. PRESIDENT:

We, your committee on Taxation having had under consideration Senate Bill No. 278 (first reading copy -- white), respectfully report that Senate Bill No. 278 do pass.

Signed: _____
Mike Halligan, Chairman

2-14-91
Asst. Coord.

2-14 1625
Sec. of Senate



GUARANTEES MONTANA TAXPAYERS RIGHTS IN

THREE IMPORTANT AREAS:

- THE ADMINISTRATION OF TAXES,
- THE COLLECTION OF TAXES, AND
- ACCESS TO TAXPAYER ASSISTANCE.

SENATE TAXATION
EXHIBIT NO. 1
DATE 2/14/91
BILL NO. SB 279

ADMINISTRATION OF TAXES

★ ★ ★ ★

A MONTANA TAXPAYER HAS RIGHTS TO:

1. RECORD ANY INTERVIEW, MEETING OR CONFERENCE WITH AUDITORS OR ANY OTHER REPRESENTATIVE OF THE DEPARTMENT.

2. HAVE A TAXPAYER REPRESENTATIVE TO ASSIST REPRESENTING THE TAXPAYER'S INTERESTS BEFORE THE DEPARTMENT OR A TAX APPEAL BOARD.

3. OBTAIN AND RELY ON TAX ADVICE FROM THE DEPARTMENT. IF SUCH ADVICE IS NOT CORRECT, THE TAXPAYER IS ENTITLED TO WAIVER OF ANY PENALTIES AND INTEREST ASSESSED AS THE RESULT OF RELIANCE ON SUCH ADVICE.

COLLECTION OF TAXES

* * * *

A MONTANA TAXPAYER HAS RIGHTS TO:

1. REQUEST TO PAY DELINQUENT TAXES ON AN INSTALLMENT BASIS PROVIDED THE TAX IS ASSESSED BY THE DEPARTMENT AND THE PAYMENT MEETS REASONABLE CRITERIA.

2. A CLEAR AND COMPLETE EXPLANATION OF ANY ADDITIONAL TAX ASSESSED.

3. MANAGEMENT LEVEL REVIEW OF AN AGENT'S ACTIONS AND A FULL EXPLANATION OF AVAILABLE APPEAL REMEDIES.

4. RECOVER COURT COSTS IF THE DEPARTMENT IS FOUND TO HAVE BROUGHT A FRIVOLOUS ACTION.

5. A FULL EXPLANATION OF THE DEPARTMENT'S AUTHORITY AND TAXPAYER PROTECTION IN A COLLECTION PROCEEDING.

6. IMMEDIATE RELEASE OF LIENS UPON PAYMENT OF TAXES DUE OR DISCOVERY OF AN ERROR.

7. A GUARANTEE THAT DEPARTMENT EMPLOYEES ARE NOT PAID, PROMOTED OR IN ANY WAY REWARDED ON THE BASIS OF THE NUMBERS OF ASSESSMENTS OR COLLECTIONS FROM MONTANA TAXPAYERS.

TAXPAYER ASSISTANCE

* * * *

A MONTANA TAXPAYER HAS RIGHTS TO:

1. EASILY UNDERSTANDABLE TAX INFORMATION.

2. CORRECT AND CLEAR ANSWERS TO TAXPAYER QUESTIONS.

3. ASSISTANCE IN PREPARING RETURNS AND OTHERWISE COMPLYING WITH MONTANA'S TAX FILING REQUIREMENTS.

4. TO KNOW HE/SHE HAS A PERSON (TAXPAYER ASSISTANT) WORKING TO INSURE THE DEPARTMENT PROVIDES:

   A. PROMPT PROFESSIONAL SERVICE

   B. TIMELY RESOLUTION OF COMPLAINTS

   C. AN OBJECTIVE REVIEW OF DEPARTMENT COLLECTION ACTIVITIES

280

STANDARDIZE THE ADMINISTRATION AND COLLECTION OF CERTAIN MISCELLANEOUS TAXES

Background:

Legislation is required to standardize the statute of limitations, the credit and refund requirements, and penalty and interest provisions.

The 9-1-1 Emergency Telephone has penalty and interest provisions but does not prescribe the specific amount of penalty and interest. Tramway and Rural Electric Fees have no penalty or interest provisions but like taxes do; little incentive exists to timely comply with the requirements. Other taxes have confusing due dates and penalty and interest provisions.

The following table lists the taxes/fees and the specific areas addressed in the legislation (those areas asterisked under P & I are revisions to present penalty and interest statutes):

Tax/Fee	S.O.L.	Credit/ Refund	P & I	Other
9-1-1 Fee	**	**	**	(1)
Telephone Tax			**	
Freightlines Tax			**	
Accommodations Tax		**	**	(2)
Tramway Assessment	**	**		(3)
Rural Electric Fee	**	**		(4)
Consumer Counsel Fee	**	**	**	
Public Service Fee	**	**	**	

The **penalty and interest** language reflects a 10% penalty for both a delinquency and deficiency and interest at 1% per month. The interest calculation is based on the tax (only and not tax PLUS penalty). Penalty attaches to a deficiency if not paid within 10 days.

The **statute of limitations** is uniform at 5 years. **Overpayments** will be applied to any receivable owing and the balance refunded to the taxpayer. Interest is allowed

SENATE TAXATION
EXHIBIT NO. 2
DATE 2/14/91
BILL NO. SB 280

on overpayments under certain conditions.

(1) The 9-1-1 amendments provide for a 10% penalty and 1% per month interest.

(2) The Accommodations Tax was amended to clarify the due date (conflicting due dates created problems for our taxpayers) and to uniformize the penalty.

(3) & (4) The Tramway Assessment and Rural Electric Fee were amended to clarify due dates and provide for 10% penalty and 1% per month interest on delinquencies and deficiencies.

Number of Taxpayers Affected by Changes

Tax/Fee	Filers	Collections FY90
Consumer Counsel	702	$ 693,334
Public Service	148	$1,571,595
9-1-1 Emergency Fee	19	$1,085,524
Telephone Tax	21	$3,760,038
Accommodations Tax	1,125	$5,488,764
Tramway Assessment	15	$ 28,755
Rural Electric Fee	40	$ 12,127
Freightlines Tax	14	$1,166,312

S.B. 333

REGULAR CORPORATION

PROFITS/LOSSES

TAXABLE AT CORPORATION LEVEL

Distributed Dividends

TAXABLE AT SHAREHOLDER LEVEL

SENATE TAXATION
EXHIBIT NO. 3
DATE 2/14/91
BILL NO. SB 333

S CORPORATION

Qualifications

- 35 Shareholders
- 1 Class of Stock

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

PROFITS/LOSSES PASS THROUGH

- Whether distributed or not - included in shareholder Federal AGI

TAXABLE AT SHAREHOLDER LEVEL

S CORPORATION

CURRENT LAW

ELECTION

MT TAX TREATMENT
§ 15-31-202

M.T. REGULAR	MT. S CORP
Exception § 15-30-111	$10.00 Fee
TAXABLE AT CORPORATE LEVEL 6 3/4%	
	PROFITS/LOSSES
DISTRIBUTED DIVIDENDS	
TAXABLE AT SHAREHOLDER LEVEL (Only on actual distribution)	TAXABLE AT SHAREHOLDER LEVEL

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 1987 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.

SENATE BILL 333
FACT SHEET

STATE TREATMENT OF S CORPORATION

- OF THE FORTY FIVE (45) STATES THAT TAX CORPORATIONS, FIVE STATES DO NOT RECOGNIZE S CORPORATION STATUS

  THESE FIVE STATES ARE:

  CONNECTICUT
  MICHIGAN
  NEW HAMPSHIRE
  NEW JERSEY
  TENNESSEE

- OF THE FORTY (40) STATES THAT RECOGNIZE S CORPORATION STATUS, EIGHT (8) STATES REQUIRE A SEPARATE ELECTION AT THE STATE LEVEL. THE OTHER THIRTY TWO (32) STATES FOLLOW THE ELECTION MADE AT THE FEDERAL LEVEL.

- ONLY TWO STATES ALLOW THE OPTION TO ELECT OUT OF S CORPORATION STATUS (CALIFORNIA & WISCONSIN)

MONTANA S CORPORATION BREAKDOWN

- 21,500 CORPORATIONS FILE RETURNS WITH THE CORPORATION TAX DIVISION

- OF THE 21,500 CORPORATIONS, A LITTLE OVER 25% OR 5,400 OF THESE ARE S CORPORATIONS.

- OF THE 5,400 S CORPORATIONS, BETWEEN 1 & 2% ELECT OUT OF BEING A S CORPORATION FOR MONTANA PURPOSES AND FILE AS A REGULAR CORPORATION FOR MONTANA PURPOSES (BETWEEN 50 & 100)

State of Montana

Stan Stephens, Governor

Department of Revenue
Denis Adams, Director

Income and
Miscellaneous Tax Division
Jeff Miller, Administrator

February 12, 1991

MEMORANDUM

TO: House and Senate Tax Committees

FROM: Denis Adams, Director

RE: Analysis of Taxpayers Who Paid No Tax In 1988 And 1989

Last year, two separate studies were done on taxpayers who had a federal adjusted gross income in excess of $100,000 and yet, paid no Montana income tax. The first year that was looked at was 1988 and the second year was 1989.

In 1988 there were 26 taxpayers who had a federal adjusted gross income in excess of $100,000 and did not pay any Montana income tax. In 1989, there were 50 taxpayers who met the criteria and did not pay any Montana income tax. Only one taxpayer showed up in both studies. (26 + 50 - 1 = 75 distinct taxpayers.)

We then combined both studies and analyzed the 75 taxpayers' filings to look for consistent patterns occurring over the last two years' returns - 1988 & 1989. We found two different areas on the Montana return caused taxpayers to pay no Montana tax. These areas are the **adjustments from federal adjusted gross income** to arrive at Montana adjusted gross income and the **itemized deductions**. These areas are further analyzed below:

ADJUSTMENTS FROM FEDERAL AGI

The majority of income excluded as an adjustment from federal adjusted gross income fell into seven categories. The largest three categories are:

1. U. S. Interest Income
2. Out-Of-State S Corporation Income
3. Montana Net Operating Losses

The remaining categories are:

4. Indian Income
5. Active Duty Pay
6. Capital Gains Exclusion
7. Retirement Income

ITEMIZED DEDUCTIONS

The returns that paid no income tax either 1) contained itemized deductions in excess of the taxpayer's federal adjusted gross income, or 2) the combination of the taxpayer's adjustments and his itemized deductions exceeded his/her federal adjusted gross income. The largest two itemized deductions reducing the Montana adjusted gross income were the:

1. Federal tax deduction
2. Investment interest deduction

The remaining principal deductions are as follows:

3. Home Mortgage Interest Deduction
4. Personal Interest Deduction
5. Contribution Deduction, &
6. Medical Deduction

CONCLUSIONS

Out of the seventy five taxpayers returns filed we found:

53 paid tax in one of the two years;

22 paid no tax in either year.

Of the twenty two that paid no tax in either year, six were from the 1988 study and sixteen were from the 1989 study. There was **no single** consistent adjustment from federal adjusted gross income that would explain why they paid no tax. However, in looking at the itemized deductions, a consistent pattern of large federal tax deductions and home mortgage interest did stand out.

The analysis proved there is a high degree of variability of reasons to explain why a person could have high federal income and yet pay no Montana Income Tax. Of this population, 29% paid no tax in either year.

The following is a breakdown by year showing the number of taxpayers who paid no tax:

Taxpayers Selected Based On:	1988	1989
1988 Study	(26)	6
1989 Study	17	(50)
Total	43	56

The above breakdown does not count those taxpayers who were nonresidents and did not file Montana income tax returns because they did not have any Montana income. Of the twenty-six taxpayers in 1988, one was a nonresident in 1989 and of the fifty taxpayers in 1989, two were nonresidents in 1988.

One final comment, because the returns filed indicated no tax does not mean that there may not be tax owing. The project identified a number of potential audit issues which we will follow-up.

Attached are four schedules showing a further analysis of the returns by year.

Attachments

ANALYSIS OF 1988 RETURNS WITH FEDERAL ADJUSTED GROSS INCOME IN EXCESS OF $100,000 WHO PAID NO MONTANA INCOME TAX

# OF RETURNS	%	ANALYSIS OF RETURNS
4	15.4%	A combination of a large 2% miscellaneous deduction and federal tax, investment interest, savings bonds interest and retirement deductions zeroed out the tax liability in these returns.
2	7.7%	A combination of a large Montana Capital Gain deduction, federal tax paid and interest deducted.
1	3.8%	This return had a large Montana net operating loss combined with federal tax paid and interest deducted to offset his income.
2	7.7%	Two returns did not have any MT income tax liability because they had a large non Montana S corporation income exclusion and federal tax deduction which zeroed out their tax liability.
8	30.8%	Eight returns had a federal tax deduction that exceeded 100% of the MT adjusted gross income.
1	3.8%	One return did not have any MT income tax liability because the medical deduction exceeded their MT adjusted gross income.
1	3.8%	One return had a combination of investment interest & mortgage interest that exceeded 100% of the federal adjusted gross income.
7	27.0%	Seven returns combined itemized deductions and personal exemptions to exceed 100% of their MT adjusted gross income.
26	100.0%	

ANALYSIS OF 1989 RETURNS WITH FEDERAL ADJUSTED GROSS INCOME IN EXCESS OF $100,000 WHO PAID NO MONTANA INCOME TAX

# OF RETURNS	% OF RETURNS	ANALYSIS OF RETURNS
8	16.0%	Eight returns had a negative Montana adjusted income after subtracting out adjustments in arriving at MT AGI.
20	40.0%	Twenty returns had a federal tax deduction that was in excess of 100% of their MT adjusted gross income.
1	2.0%	One return had a medical deduction that was in excess of their MT adjusted gross income.
9	18.0%	Nine returns had two major deductions that when combined exceeded 100% of their MT adjusted gross income.The deductions were the federal tax deduction, contribution deduction, medical deduction, investment interest deduction or misc. deductions.
5	10.0%	Five returns have three major deductions when combined exceeded 100% of their MT adjusted gross income. The deductions were the federal tax deduction, investment interest deduction, contributions deduction, other taxes deduction, home interest deduction, medical deduction or misc. deductions.
2	4.0%	Two returns had up to six deductions when combined exceeded 100% of their MT adjusted gross income. The deductions were the federal tax deduction, other taxes deduction, home interest deduction, personal interest deduction, investment interest deduction, or contribution deduction.

ANALYSIS OF 1989 RETURNS (CONT.)

5	10.0%	Five returns had itemized deductions ranging from 89% to 98% of their MT adjusted gross income. When combined with their exemption deductions the result exceeded their MT adjusted gross income.
50	100.0%	

TOTAL ADDITIONS AND DEDUCTIONS FOR 1988 NON TAX FILERS

NO. OF RETURNS	26		25	
TAY YEAR	1988	%	1989	%
FED AGI	**5,990,926**	**100.00%**	**8,181,071**	**100.0%**
ADD				
NON MT. INT	112,118	1.9%	133,346	1.6%
FED REF.	189,763	3.2%	639,740	7.8%
TRUST INCOME	13,458	.2%		
LESS				
U.S. INT.	203,308	3.4%	260,319	3.2%
ELDERLY INT.	7,200	.1%	6,400	.1%
RETIREMENT	39,802	.7%	50,160	.6%
STATE REFUND	51,375	.9%	120,182	1.3%
CAPITAL GAINS	117,172	2.0%	74,023	.9%
S CORP. INCOME	1,662,531	27.8%	1,766,052	21.6%
N. O. L.	223,198	3.7%		
SOCIAL SECURITY			15,329	.2%
NON MT INCOME			1,697,968	20.8%
NON-MT. TRUST	6,608	.1%	9,777	.1%
NON-MT FIDUCIARY	16,505	.3%	5,962	.1%
UNEMPLOYMENT	2,090	.04%	1,536	.02%
FED. REF-NO BENEFIT	54,345	.9%		
MT AGI	**3,908,673**	**100.0%**	**4,959,907**	**100.0%**
FED. TAX	4,542,682	116.2%	1,404,602	28.3%
OTHER TAXES	67,066	1.7%	92,913	1.9%
HOME INT.	229,927	5.9%	219,867	4.4%
PERS. INT.	248,005	6.4%	67,754	1.4%
INVEST. INT.	422,732	11..3%	422,260	8.5%
CONT. DED	162,353	4.2%	193,185	3.9%
2% MISC. DED.	258,987	6.6%	176,829	3.6%
OTHER MISC.	7,749	.2%	10,000	.2%
MEDICAL			12,207	.3%
AMT. TAXABLE	**(2,098,915)**		**2,281,948**	
TAX LIAB.	**-0-**		**279,935**	

TOTAL ADDITIONS AND DEDUCTIONS FOR 1989 NON TAX FILERS

NO. OF RETURNS	48		50	
TAX YEAR	1988	%	1989	%
FED AGI	**21,515,391**	**100.0%**	**9,483,353**	**100.0%**
ADD				
NON MT. INT.	244,902	1.1%	275,192	2.9%
FED REF	199,236	.9%	56,098	.6%
TRUST INCOME	5,422	.03%	16,387	.2%
CAPITAL GAINS	25,884	.1%		
LESS				
U.S. INT	918,788	4.3%	1,601,216	16.9%
ELDERLY INT.	18,400	.09%	24,000	.3%
RETIREMENT	84,751	.4%	231,124	2.4%
STATE REFUND	38,539	.2%	230,153	2.4%
CAPITAL GAINS	81,900	.4%	114,719	1.2%
S CORP.	1,262,502	5.9%	1,404,334	14.8%
N.O.L.	1,999,119	9.3%	2,761,387	29.1%
SOCIAL SECURITY	8,001	.04%	14,257	.2%
NON MT INCOME	3,028,474	14.1%	402,328	4.2%
NON MT TRUST	88,283	.4%	132,489	1.4%
ACTIVE DUTY PAY	167,928	.8%	212,186	2.2%
INDIAN INCOME	513,847	2.4%	530,601	5.6%
MT AGI	**13,780,303**	**100.0%**	**2,172,236**	**100.0%**
FED. TAX	3,998,103	29.0%	4,341,243	199.9%
OTHER TAXES	103,470	.8%	142,595	6.6%
HOME INT.	218,140	1.6%	257,831	11.9%
PERS. INT.	21,220	.2%	15,784	.7%
INVEST. INT.	328,049	2.4%	1,122,916	51.7%
CONT. DED	320,001	2.3%	257,026	11.8%
2% MISC. DED.	53,388	.4%	103,626	4.8%
OTHER MISC.	23,850	.2%	24,220	1.1%
MEDICAL	84,142	.6%	173,418	8.0%
STANDARD DED.	2,032	.01%		
AMT. TAXABLE	**8,200,156**		**(4,460,562)**	
TAX LIAB.	**1,391,743**		**-0-**	

Timothy J. Wylder

Attorney At Law

305 Liberty Center
9 Third Street North
Great Falls, Montana 59401

(406) 453-1966

March 23, 1990

Mr. Denis Adams, Director
Department of Revenue
Sam Mitchell Building
Helena, Montana 59620

Dear Denis:

Thank you for the opportunity to discuss S corporation issues with you last Friday. I have set forth my legal analysis in the enclosed Memorandum of Law. Although I am an advocate in this matter, I truly believe that my analysis is the better one.

I would like to set forth in this letter what I might call my institutional fairness argument. Several years ago when my clients and I were contemplating some out-of-state business ventures and investments, Kent Borglum and I undertook the sort of analysis I have set forth in my Memorandum, and Kent confirmed it with senior Montana Department of Revenue personnel. They agreed with our treatment of this issue, so we went ahead and participated in the organization of several out-of-state corporations and managements and consented to S corporation treatment for them. Then, unbeknown to us, along comes Professor Eck with some out-of-state S corporation losses he wants to use, and the Department produces a summary, result-oriented legal opinion and changes the rules on us without an opportunity to be heard, all in the face of plain statutory language to the contrary.

This is manifestly unfair and severely undermines professionalism in tax planning and administration. As a tax professional from the private sector and as an appointee of Governor Stephens, this should be of special concern to you. Thus, even if the merits of the alternative rules were equal, fairness would dictate that the Department return to its former position and practice (before the Eck initiative), which we relied on in good faith. The legislative burden should be on the Eck's of the world who would change the plain language of the statute and established administrative practice.

Thank you very much for your time and consideration. If you have any questions, do not hesitate to call.

Very truly yours,

Timothy J. Wylder

SENATE TAXATION
EXHIBIT NO. 4
DATE 2/14/91
BILL NO. SB 333

cc: Kent Borglum

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.

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.

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"

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.

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.

DAH/jb

COPY

Junkermier · Clark
Campanella · Stevens · P.C.
Certified Public Accountants

Ward F. Junkermier, CPA
George L. Campanella, CPA
Stone E. Paulson, Jr., CPA
Rick A. Frost, CPA
Robert E. Nebel, CPA
Joseph F. Shevlin, CPA
Ronald A. Taylor, CPA
Kent A. Borglum, CPA
Terry L. Alborn, CPA
William J. Eidel, CPA
Walter J. Kero, CPA

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]

600 Central Plaza • Suite 208 • P.O. Box 989 • Great Falls, Montana 59403 • (406) 761-2820 • FAX 761-2825
Offices in: Missoula, MT 59807-8929 • P.O. Box 8929 • 406-549-4148
Helena, MT 59625 • Montana Club Bldg. • P.O. Box 1164 • 406-442-6901

[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

PROPOSED AMENDMENTS TO SENATE BILL 333

SUBMITTED BY

TIMOTHY J. WYLDER

February 14, 1991

Article I. Add a New Section to SB 333 before Section 1. A new subsection to 15-31-111(2), MCA, is added and reads as follows:

"(2) Notwithstanding the provisions of the federal Internal Revenue Code of 1986, as labeled or amended, adjusted gross income does not include the following which are exempt from taxation under this chapter:

. . .

"(b) gains, profits, or income not actually or constructively received by a cash basis taxpayer from any corporation, insurance company, investment company, mutual fund, trust, or similar entity; for the purposes of this subsection, "constructively received" shall have the meaning generally understood in income tax accounting matters;"

Article II. Section 1 of SB 333 is amended as follows:

At page 4, line 18 of the SB 333, strike lines 18 through 22 and substitute the following language:

"(3) In the case of a shareholder of a small business corporation as defined in 15-31-201, as amended, except as provided in 15-31-202, as amended, adjusted"

then continue at page 4, line 23 and following without deleting the language of 15-30-111(3), MCA, as it currently reads.

Article III. Add New Section to SB 333 following Section 2. Section 15-30-121(2), MCA, is amended to read:

"15-30-121. In computing net income, there are allowed as deductions:

. . .

"(2) federal income tax paid within the taxable year, but only to the extent that the federal income tax paid is attributable to income items included in the taxpayer's Montana adjusted gross income under 15-30-111;"

SENATE TAXATION
EXHIBIT NO. 5
DATE 2/14/91
BILL NO. SB333

Article IV. Section 4 of SB 333 is amended at page 12, line 19 in the same manner as Section 1 of SB 333 is amended in Amendment I above.

Article V. Section 7 of SB 333 is amended as follows:

Add to the end of the sentence at page 16, line 10 the following language:

"to the extent that the corporation's net income is subject to the tax imposed by this chapter without regard to this section."

DATE 2/14/91

COMMITTEE ON Senate Taxation

VISITORS' REGISTER

NAME	REPRESENTING	BILL #	Check One	
			Support	Oppose
Dave Woodgerd	DOR	279	✓	
pd mail	DOR	280 279/333	✓	
Lloyd Schaudn		333	AMEND	
James M Wylder	self	333		✓
Joseph F. SHEILD		333		✓
Tim Wylder	self	333		
Dennis Burr	MT Taxpayers Assn	279 280	✓	
James Tutwiler	MT Chamber Commerce	SB 279	✓	
Ann Mary Dussault	MACo			

(Please leave prepared statement with Secretary)