

MINUTES

MONTANA SENATE 55th LEGISLATURE - REGULAR SESSION

COMMITTEE ON TAXATION

Call to Order: By VICE CHAIRMAN MIKE FOSTER, on January 10, 1997, at 10:00 a.m., in Room 415.

ROLL CALL

Members Present:

Sen. Mike Foster, Vice Chairman (R)
Sen. Mack Cole (R)
Sen. Bob DePratu (R)
Sen. Wm. E. "Bill" Glaser (R)
Sen. Barry "Spook" Stang (D)
Sen. Fred R. Van Valkenburg (D)

Members Excused: Sen. Gerry Devlin, Chairman (R)
Sen. Dorothy Eck (D)
Sen. Mike Sprague (R)

Members Absent: None

Staff Present: Jeff Martin, Legislative Services Division
Sharon Cummings, Acting Committee Secretary

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

Committee Business Summary:

Hearing(s) & Date(s) Posted: SB 100, 1/7/97; SB 122,
1/7/97
Executive Action: SB 20

HEARING ON SB 100

Sponsor: SEN. TOM BECK, SD 28, DEER LODGE

Proponents: Al Kington, Montana Tree Farm Committee
Don Allen, Montana Wood Products Association
Randy Pierson, Department of Revenue

Opponents: None

Opening Statement by Sponsor:

SEN. TOM BECK, SD 28, DEER LODGE, asks the committee to clarify the classification of forest lands for property tax purposes.

This bill crosses out a very cumbersome formula for coming up with the .79% tax rate against productivity of the land for forest products. The Department will explain this bill which is revenue neutral.

{Tape: 1; Side: A; Approx. Time Count: 10:03; Comments: None.}

Proponents' Testimony:

Al Kington, Consultant Forester from Helena, speaking in support of this bill on behalf of Montana Tree Farm Committee. A committee has been involved with this productivity tax legislation since 1994. They have been holding meetings with the landowners and feel it is a good system. There is an increase in productivity taxes this year that the committee members have had to explain in depth to their people. They believe this is needed to make the bill more understandable.

{Tape: 1; Side: A; Approx. Time Count: 10:05; Comments: None.}

Don Allen, Montana Wood Products Association, speaks in support of SB 100. The DOR contacted the organization recently asking them to take a look at clarifying language dealing with the annual net wood production and the formula. The Forest Service has had problems explaining the numbers they use. The MWPA Tax Committee met with the DOR and determined this would be a good change in the productivity tax bill. In addition, in drafting the legislation, some of the language that is stricken, sub-sections 3 & 4 dealt with cleanup, making sure that obsolete language was deleted and that the formula in statute was translated and updated to work. Valuations are up this year which is supposed to happen. MWPA believes the changes made in 1991, which are now coming into fruition, regarding new appraisal values proves that the system is workable, sound, defensible and fair. MWPA believes it is time for these changes to be made and eliminate the obsolete language.

Opponents' Testimony: None

{Tape: 1; Side: A; Approx. Time Count: 10:08; Comments: None.}

Questions From Committee Members and Responses:

SEN. "SPOOK" STANG, asks for an explanation of the old formula and how the figure .079 was arrived at on the new formula. What assurance is there that the change will have no fiscal impact?

Randy Pierson, Department of Revenue (DOR), explains that the changes in this bill will have no direct fiscal impact in the upcoming reappraisal. The issues being changed are simply clarifying and eliminating outdated language in the bill. The formula is not being changed.

SEN. STANG asks how the .079 correlates to the old formula.

Mr. Pierson explains the Forest Lands Tax Act was implemented in 1994. The new forest tax system was a taxable value neutral reappraisal. This language was the mechanism used to calculate a new taxable percentage for the new tax system so that it would be taxable value neutral, statewide. In 1993 the taxable percentage was 4% on forest lands, in 1994 with the new system the appraised values were much higher so this mechanism was the process we used to correct the taxable value so they would, on the average statewide, match up with what we had in 1993. That language was only applicable for creating the new taxable percentage in 1994. The .079 is what was used in 1994, 1995, 1996, 1997, etc. unless someone decides they want to come in and change that taxable percentage. This bill eliminates a lot of language and gets to the heart of the matter.

SEN. STANG asks for clarification on page 2, line 16. The definition of what is forest land seems to have changed. What about people with 20 and 40 acre tracts that were considered timberland? Will they be thrown into some other classification because of this definition?

Mr. Pierson explains this is the definition used. When this statute was created in 1991 it was unknown what the minimum productivity level was going to be designated as commercial forest land. The 25 cubic feet is a baseline. Any land that cannot produce at least 25 cubic feet per acre is considered as non-commercial forest land. The DOR had to wait until the classification was developed by the University of Montana School of Forestry and the Department looked at the modeling process before deciding on a specific number.

SEN. STANG asks if legislators will get letters from people with timberland that may get reclassified out of the timberland. He wants to know if there are going to be any taxpayers affected by this change in language.

Mr. Pierson responds no, there is no change from the way the DOR is doing it now. He points out that the language being eliminated was extremely confusing. The word "or" instead of "and" in the definition of forest land made some people infer that all they had to do was supply the DOR with an intent to harvest their timber in the future and that would automatically grant them forest classification. There could be a scenario where somebody in Northeastern Montana, say Richey, has 19 acres of bare land valued at market. They could read the current bill and say all they have to do is give the DOR a statement of intent to harvest timber even though they have no timber, have never had any timber and they would get forest land classification. The Department is sure that wasn't the intention of the legislature. The DOR has struggled with this language since 1994 and feel now is a good time to clarify it.

SEN. STANG asks how many and what size trees per acre are necessary to come up with 25 cubic feet.

Mr. Pierson responds that when potential productivity is estimated the DOR is looking at the lands ability to produce that amount of volume.

Mr. Kington states that a 7 inch tree 30 feet high would be in that range.

SEN. FRED VAN VALKENBURG states he understands the .79% figure is a number derived at in order to keep the statewide average at a revenue neutral basis. He assumes that individual taxing jurisdictions are going to have different impacts as opposed to the statewide average. He asks, "Can you tell me if that is a correct assumption and if so, have you made any effort to determine the impact on individual taxing jurisdictions?"

Mr. Pierson responds **SEN. VAN VALKENBURG'S** assumption is correct. In 1994 there were changes to individual landowners and different taxing jurisdictions across the state. Some landowners saw their forest taxes go up, and some saw them go down. Most of them stayed relatively the same.

SEN. VAN VALKENBURG asks what will happen in 1997.

Mr. Pierson says the same tax rate will stay in effect, .79%, so the bill simply carries forward the same tax percentage.

VICE CHAIRMAN MIKE FOSTER states this is the percentage that was put into place in 1994 and is now being put into statute. He asks **SEN. VAN VALKENBURG** if he would like to have any worksheets or spreadsheets that show by county what happened in 1994?

Mr. Pierson responds that is correct. He has worksheets on a county basis but not on a taxing jurisdiction basis.

SEN. VAN VALKENBURG states if the tax is no different than it has been for the past two years he is not interested in seeing them.

SEN. BILL GLASER asks if in the process of correcting Class 4 residential and commercial property, the department has been considering tweaking some of these other taxes to make them equitable to the residential people. Are they considering tweaking Class 10?

Mr. Pierson responds not to his knowledge. The DOR has a formula and procedures in place for accumulating the data that goes into the formula. They did not do anything different this time than they did in the last reappraisal as far as developing new reappraisal values.

SEN. GLASER asks if the decision is made to decrease the education levies by 15 mills, then Class 10 property would get a benefit at the expense of the residential, is that correct?

Mr. Pierson states that is correct. An individual may have taxable value in several different tax classes and it is all combined in their overall taxable value pool that the mill levies apply to. If mill levies drop, taxes per acre of forest land would decrease. Forest land valuations are increasing, as well as residential in 1997. They are not increasing as a result of these changes.

SEN. GLASER asks if they are increasing to the 28% of the average rate?

Mr. Pierson responds they are going up considerably more. Statewide, the DOR estimated that they are going up by approximately 124% or 126%.

SEN. GLASER asks for **Mr. Allen's** thoughts on an increase of 124% against the 30% residential increase in lieu of the fact that may be adjusting mandatory levies for education.

Mr. Allen responds this is something that the MWPA is aware could happen. The values are going up which will result in a higher tax. The feeling overall is that the formula, with the 5 year rolling average and as stumpage numbers go up, pretty well reflects what is happening. It is a built in reappraisal adjustment on top of what else is happening regarding property reappraisal. No one is upset about this but they have received some questions about it. Overall it should correlate pretty closely with what their land is worth in view of what they can get for the timber. It can go up and down in different cycles depending on what is happening in the marketplace.

CHAIRMAN GERRY DEVLIN asks **Mr. Allen** why the amount 25 cubic feet is arrived at.

Mr. Allen responds that may have been answered before **CHAIRMAN DEVLIN** arrived. It is an attempt to get away from the confusion that was created by the language that caused some people to think they could file a statement of intent to harvest as a way to get a change in classification.

{Tape: 1; Side: A; Approx. Time Count: 10:20; Comments: None.}

Closing by Sponsor:

SEN. BECK has amendment #1544103 section 6, which bases the capitalization base with the Federal Land Bank Association's interest rates calculated through their agriculture loans. There is no longer a Federal Land Bank; it is called the Northwest Farm Credit Services, Agriculture Credit Association of Spokane. He asks that the committee consider this amendment also, which will be handed out when Executive Action is taken.

{Tape: 1; Side: A; Approx. Time Count: 10:25; Comments: None}

HEARING ON SB 122

Sponsor: SEN. DELWYN GAGE, SD 43, CUT BANK

Proponents: Don Hoffman, Department of Revenue

Opponents: Gail Abercrombie, Montana Mining Association
Jerome Anderson, Shell Western Exploration &
Production, Inc.
Dennis Burr, Montana Taxpayers Association
Patrick Montalban, Northern Montana Oil & Gas
Association
Angela Janacaro, Montana Mining Association

Opening Statement by Sponsor:

SEN. DELWYN GAGE, SD 43, CUT BANK, introduces SB 122 at the request of the Department of Revenue. SEN. GAGE is concerned with the section, sub 5, page 1, requiring an employee to handle personal liability on the tax. SEN. GAGE spoke with Greg Petesch about this and was told that's in the income tax section of the code. SEN. GAGE is wondering if this is changed, should the income tax code be changed in accordance with this bill. Mr. Petesch responded this has been in the code for quite some time and is in other sections of the code regarding taxes. SEN. GAGE can understand the reasoning behind this, there are little corporations where a person owns all the stock, is the operator, does all the work on the wells and files all the returns. The question is, does he hide behind the corporation because the corporation is listed as the operator and in actuality it is, does it come out of the right pocket or the left pocket? SEN. GAGE wants to bring this to the Committee's attention for consideration when Executive Action is taken.

{Tape: 1; Side: A; Approx. Time Count: 10:28; Comments: None.}

Proponents' Testimony:

Don Hoffman, Department of Revenue (DOR), Natural Resources Bureau, gives some background as to why DOR requested this bill. In Montana law the operators are responsible for reporting and paying the oil and natural gas production taxes. In many instances the purchaser of the oil or natural gas will withhold the taxes for all the interest owners and send those taxes to the operator because he is responsible for filing them. In some instances operators haven't forwarded those taxes. This is very much like a withholding situation where a tax is withheld from employees in trust. There have been situations where the DOR has taken steps to go back to those same interest owners for the taxes that haven't been paid on their behalf. There is an opinion from DOR's legal staff that says ultimately those interest owners could be held responsible. A royalty owner could probably get pretty excited about having all these taxes withheld and now the DOR is saying they'd like to come after him/her

because the operator is not paying them. The operator is hiding behind the corporation and the DOR can't go after him or her. This bill will allow the DOR to go after the people who are responsible for getting the money that was held on behalf of other interest owners in the property.

Mr. Hoffman states that with respect to the other issue brought up by **SEN. GAGE**, this statute was basically taken from the income tax statute and says the same thing. For the committee's consideration, he handed out the regulations that the Income Tax Division uses in administering their portion of the law.

(EXHIBIT #1) There are certain steps the DOR goes through to determine that the individual is liable. **Mr. Hoffman** explained (EXHIBIT #1). He spoke with the Income Tax Division after **SEN. GAGE** expressed his concern. The DOR sends out a letter warning people about this and envisions the same process will be used with this bill. The DOR is not trying to "get" the clerk that filed the returns at the direction of someone in the company. The Department is trying to make sure that there is another avenue for collecting from someone who has been less than up front with the DOR.

{Tape: 1; Side: A; Approx. Time Count: 10:30; Comments: None.}

Opponents' Testimony:

Gail Abercrombie, Executive Director, Montana Petroleum Association, states she sent copies of this bill to their members. She has not received any negative responses to section 3 & 4 regarding setting aside procedures. She received a phone call from a lady who is an accountant with a firm, asking if she should resign now or later because she doesn't know if the DOR is going to come after her house or kid's college fund with the personal liability. If it is as **Mr. Hoffman** states, that it is not the intent to go after these types of people, it needs to be very clear. This is the oil and gas section of statute and it needs some clarification before her members will be comfortable with reaching back to an employee. She is still nervous and uncomfortable with this.

Jerome Anderson, Shell Western Exploration and Production Inc., states they have the same concerns as **Ms. Abercrombie** states with regard to sub-section 5 which is the section that puts liability on various entities within the corporate structure for the payment of the tax. It has been stated this would only apply to taxes withheld, but if he reads the statute correctly, the second line says, "shall pay the tax in full for the operators own account and for the account of others." He thinks this would cover the entire tax burden of the corporation. In Shell's case that tax burden, on an annual basis, is somewhere between \$9-10 million. Reportedly, this type of approach is not taken with regard to oil and gas production taxes generally in other jurisdictions across the United States. He believes, at a recent legislative session in the State of Florida, the same effort was

made and was not successful. He understands there is a rather severe penalty for failure to pay the taxes by the operators concerned. There is no problem with the balance of the bill. The liability section is too excessive. He urges amendment of the bill to take that feature out.

Dennis Burr, Montana Taxpayers Association, thinks the last statement which is apparently taken from income tax withholding statute doesn't have the same effect in this bill as it does with income tax. As an employer under the income tax, he would be required, by law, to withhold from an employee's salary and keep that money separate to remit to the state as withholding tax. That doesn't make him responsible for the payment of that person's tax if they don't pay the tax. The concern here is that transferring this language appears to make the person who withholds responsible for the tax if the person who owns the business doesn't pay. That may be clarified in such a way to refer only to amounts that are withheld and remitted to the DOR. He agrees with the other witnesses, the way it reads now it appears to make the accountant responsible for payment of the tax and not for just remitting the withholding. That needs to be clarified at the very minimum.

{Tape: 1; Side: A; Approx. Time Count: 10:35; Comments: None.}

Patrick Montalban, President, Northern Montana Oil & Gas Association, states he is a member of approximately fifty small independent oil and gas operators in hi-line communities. He is opposing this bill for a number of reasons, most having already been stated. Most of their companies that operate on the hi-line are small independents with one secretary and no CFO or accountant. This is taking something to the individual employee and they don't have the responsibility for this. A number of people filling out these taxation and royalty reports are not even accountants but secretarial staff. He is the President and CEO of MSR, and they are not only protected through director's liability insurance, but also protected by the law so they are not personally liable for a corporation. He wants to bring the committee's attention the part regarding working interest and payment of taxes and royalties. As **Mr. Hoffman** stated, a working interest can go out and collect these royalties and taxes for the wells when they are economic. What happens when the working interest owner goes out and tries to collect their proportionate share for their partners for these royalties and taxes and the well is uneconomic and therefore there is no money to take that debt against? They are going to end up personally liable for the working interest of all the people because they fill out the paperwork. This is not fair to the working interest that is operating the well. What it is actually doing is giving the other partners in the project a way to get out from paying their taxes and royalties altogether. The other thing he looks at is the course of action they have to receive this money anyway. They can go to any court of law and recover this money. They also have the division order and the lease agreement for the

royalty owner to go back and collect the money that is due to them on an individual basis. There is plenty of recourse action for them.

Angela Janacaro, Montana Mining Association, states her organization opposes this bill for the concerns previously stated by the other opponents, especially the precedent that is set for a corporation's personal liability in sub-section 5.

Questions From Committee Members and Responses:

CHAIRMAN DEVLIN asks **Mr. Hoffman** how much money is the DOR unable to collect now.

Mr. Hoffman states he can think of two companies that represent approximately \$2.5 million that are in the situation the bill is trying to rectify.

CHAIRMAN DEVLIN asks if this would rectify it.

Mr. Hoffman states he isn't sure it would rectify this because the bill has an effective date of July 1, 1997. He is not sure the DOR can make this retroactive to apply to those circumstances. DOR is trying to fix the problem where the purchaser has withheld the money and remitted the money to the operator and the operator has not paid the DOR for it. It becomes a problem in closely held corporations. When it comes time to pay the taxes, they have them on behalf of all the other interest owners but they haven't remitted them to the DOR. There is a legal opinion that says DOR can go after those other interest owners but they have already had the tax withheld from them. This puts royalty and other working interest owners in a tenuous position when the DOR starts saying they're going to come after you.

CHAIRMAN DEVLIN asks about the possibility of amending that part out, would this bill work at all?

Mr. Hoffman states he doesn't think it would work, because the DOR is trying to be able to pursue the person who is responsible for having diverted those withholdings. If that part is taken out, there wouldn't be much left.

SEN. BILL GLASER asks if the DOR has any recommendations as to how to amend the secretaries and janitors out of this.

Mr. Hoffman states they could take a look at doing some amendments that would follow the regulations in **(EXHIBIT #1)** stating the procedures to be used. He's not aware of a circumstance where DOR has used this process to go after the clerk saying they are responsible. DOR usually goes through a process of notifying them and that results in some action.

SEN. GLASER states the major problem with government right now is that citizens don't trust government. He says, "If we send out sub-section 5 like this, it would reflect on the Committee members and we would no longer be trusted."

{Tape: 1; Side: B; Approx. Time Count: 10:45; Comments: None.}

Mr. Hoffman states it reflects a distrust in government if DOR goes after royalty owners for taxes they have already paid.

SEN. GLASER states, "We need to do things clearly enough so the citizens feel comfortable with the powers of the DOR."

Mr. Hoffman states if it would help the chances of the bill to have the DOR go back and take a look at what is in the regulation and put something like that in, they will do so. He states, "I don't know if that will alleviate all the concerns of the people who have testified today, but we are willing to talk with them and come forth with some amendments." There is a real equity issue here when talking to people who have had their taxes withheld and DOR can hold them responsible for paying those taxes again. That is the recourse as DOR sees it under the current law.

SEN. GLASER feels the DOR and administration need to understand the primary problem the legislature and the government has is developing trust in the citizenry. It is obvious that the corporate structure in Montana is very uncomfortable with this bill as it reads now. The DOR should get these secretaries and janitors out of there and make this fact clear.

SEN. BOB DEPRATU asks how the department would approach a company if this bill was in effect. He asks, "How far down the line would you go and what stopgaps would you have for one of your more overzealous tax auditors? I'm completely uncomfortable with this. I would be interested in knowing at what point you are going to say that we definitely are going to stop and not go after a person who doesn't have the ability to pay or the control of the company."

Mr. Hoffman states it is not DOR's intent to go after the people who are not ultimately responsible for doing this. DOR can take a look at coming up with some amendments that soften this somewhat and hopefully get to the people who are responsible and who have benefitted from the fact that those taxes were withheld and not remitted to the DOR.

SEN. MACK COLE feels the DOR needs to put in what its intent is so that it is clarified better.

Mr. Hoffman states they will work on it.

CHAIRMAN DEVLIN asks **SEN. GAGE** to work with the DOR and opponents to find an avenue this committee can accept.

Closing by Sponsor:

SEN. GAGE states he will work with the people involved to come up with something. Sub 3 & 4 don't have a problem because the operator ought to be responsible for paying these taxes. With a few exceptions, the operators are receiving the total proceeds from the sale other than where the purchaser is paying the royalty on it. **SEN. GAGE** has questions regarding line 15, gross value of products or in kind. This bill is not completely one-sided in favor of the DOR. He will get back to the committee with some amendments on the bill.

{Tape: 1; Side: B; Approx. Time Count: 10:55; Comments: None.}

EXECUTIVE ACTION ON SB 20

Amendments: None

Discussion: **CHAIRMAN DEVLIN** states the fiscal note shows a negative impact to the General Fund of \$84,000 each year.

SEN. COLE states it was his understanding it had a far bigger effect than \$84,000.

CHAIRMAN DEVLIN states there was an offer made to settle. The difference between that offer to settle and what the courts said to pay amounted to an impact of minus \$5-8 million.

SEN. STANG states perhaps **Steve Bender, Office of Budget and Program Planning**, could answer this question.

Mr. Bender explains the fiscal note. Under the current revenue assumptions there would not be a hit on the General Fund. Relative to the potential revenue there would be an \$84,000 bill.

CHAIRMAN DEVLIN asks if the settlement comes through, is it going to be plus \$84,000.

Mr. Bender responds if the settlement comes through there will be plus \$1.6 million, that amount is not in the revenue estimates.

Motion: **SEN. STANG** moves DO PASS SB 20

Discussion: **SEN. STANG** states the Revenue Oversight Committee didn't include the railcar tax in the revenue estimate. He states, "That is consistent with what we have done in the last 2 or 3 sessions because we didn't think we could include it until the case was settled and the money was actually coming in."

SEN. DOROTHY ECK understands this bill does not have any major impact on the settlement; it is to change the tax previously enacted.

SEN. STANG states that is correct. This basically goes along with what the settlement is; it might supply credence for the people who are negotiating to see that the legislature had decided to change the law.

Vote: The DO PASS MOTION FOR SB 20 CARRIED UNANIMOUSLY.

{Tape: 1; Side: b; Approx. Time Count: 11:03; Comments: None.}

CHAIRMAN DEVLIN explains the DOR has brought new figures regarding the property tax reappraisal. (EXHIBIT #2)

Judy Painter, DOR, explains these are the existing figures which were given to Revenue Oversight. DOR staff will be working on other figures over the weekend. Ms. Painter asks CHAIRMAN DEVLIN if he wants any comments on (EXHIBIT #2).

CHAIRMAN DEVLIN asks the Committee to read (EXHIBIT #2) and perhaps Ms. Painter could be here Monday to answer questions.

Ms. Painter states she will return on Monday.

ADJOURNMENT

Adjournment: 11:06 a.m.



GERRY DEVLIN, Chairman



SHARON CUMMINGS, Secretary

GD/SC