



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

To: Dan Bucks, Director
 From: C. A. Daw, Chief Administrative Legal Officer
 Date: September 13, 2007
 Subject: MT DOR Major Case Issues and Decisions June 2007 - September 2007

Montana Supreme Court:

Jackrabbit Red's: On August 8, the Montana Supreme Court found in favor of the Department in this liquor licensing matter. The Court sidestepped the issue of whether the Department was appropriately a party to the petition for judicial review at the district court level or to the appeal to the Supreme Court. The Court held that substantial evidence supported the Department's findings and that the Department's hearing examiner did not misapprehend the evidence. Further, the Court advised the Protestors that their broad policy-type arguments (regarding the ills of gambling and prohibition of or restrictions on locations for gambling) were better left to the Legislature. The Court affirmed judgment of the District Court affirming the Department's approval of Hare's Ear's application for transfer of ownership of the liquor license.

Mountain Monkey: This case involves the denial of an application to transfer a resort all beverages license. The Hearing Examiner concluded that because the proposed location fell outside the Big Mountain Resort Area, the application could not be transferred as proposed. Eleventh Judicial District Court Judge Lympus upheld the Department's decision. The appellant's opening brief was filed in late July, 2007. The Department filed its response brief on August 30, 2007.

U.S. West, Inc.: This case involves interest added to an assessment of corporation license taxes for 1999 which the taxpayer appealed to the State Tax Appeal Board. STAB ruled in the Department's favor in September 2006 and the taxpayer appealed to the First Judicial District Court. The district court affirmed STAB's findings stating that the interest owed by the taxpayer was due as calculated by the Department. The taxpayer initiated an appeal to the Montana Supreme Court.

Omimex 2004: First Judicial District Court Judge Sherlock entered findings of fact, conclusions, of law and order in favor of the Department on February 2, 2007. Omimex challenged the Department's authority to centrally assess its property because it claimed the central assessment statute only gives the Department authority to centrally assess properties that are physically interconnected. Omimex also challenged the Department's central assessment of its property on equalization and equal protection grounds. This case was appealed to the Montana Supreme Court. The 2005 and 2006 tax cases are being held in abeyance pending the outcome of the 2004 litigation before the Montana Supreme Court.

Shelby Distributors: This is a liquor case that revolved around whether or not a liquor wholesaler could have "any financial interest" in a liquor retail establishment. On May 1, 2007, the District Court also ruled in favor of the Department stating that a liquor wholesaler could have no direct or indirect financial interest in a retailer. Shelby appealed to the Montana Supreme Court on May 23, 2007.

Frontier Chevrolet: Frontier appealed the State Tax Appeal Board's (STAB) decision to the Thirteenth Judicial District Court claiming STAB's interpretation of 15-31-544, MCA was not correct. Judge Gustafson ruled that STAB had correctly interpreted the statute and Frontier had a duty to file an amended return with the Department as a result of an adjustments made by the IRS to the federal tax returns for the same tax years. This case involves 1995 and 1996 tax years. The matter is currently on appeal before the Montana Supreme Court.

District Court:

Fulton Producing Company: This case involves breach of contract claims as to tax delinquencies owed to the state of Montana and various counties and a tort claim filed by the state relating to transfer of real and personal property in a scheme to avoid tax collection. The First Judicial District Court ruled the Department has authority to bring the tort claims action and if certain requirements are met damages may be warranted to the state for the tort actions. The case settled at the end of July. A total of \$1,792,000 will be paid to the Department, which represents the full amount of unpaid tax and penalty, and interest on the unpaid tax through May 23, 2007.

Frontier Chevrolet: (Tax year 1994). In July, 2007, STAB granted the Department's motion for summary judgment. In doing so, STAB concluded that its prior decisions in *Frontier Chevrolet* and *Northwest Farm Credit Services* were binding-- because the taxpayer failed to file a required amended Montana return, 15-31-544, MCA, operated to toll the statute of limitations.

Gannett Satellite Information Network, Inc. (Gannett): A motion for summary judgment was filed by Gannett and the Department opposed that motion and filed a motion for partial summary judgment. The State Tax Appeal Board ruled in the Department's favor on three counts: equitable estoppel; the definition of business income (15-31-302(1), MCA; and unitary taxation. The case is significant because it establishes that both transactional and functional tests may be used to determine if a certain item of income satisfies Montana's definition of business income. Gannett initiated an interlocutory appeal to the First Judicial District Court, asking the court to consider whether § 15-31-302(1), MCA, comprises one or two tests. Once this legal issue is concluded, STAB will resume jurisdiction to determine whether the gain at issue met the transactional or functional test, whether a liquidation exception is present, and whether the taxpayer is entitled to equitable relief.

Klabzuba Oil & Gas, Inc.: The Department issued an administrative summons for information that Klabzuba has refused to provide. Klabzuba sought to quash the summons in District Court (Havre). Klabzuba moved to dismiss and sought summary judgment. On April 5, 2007, Judge Rice denied Klabzuba's motions with some language favorable to the Department. On April 12, the Department moved for summary judgment. Klabzuba filed two motions that will delay the Department's summary judgment motion until the intervening motions are decided. Oral argument on Klabzuba's two motions was held July 2 and no decision has been issued to date.

Northwest Farm Credit Services (Northwest): In September, 2006, the State Tax Appeal Board ruled in favor of the Department stating that because Northwest failed to timely file an amended Montana return at the time it filed amended federal returns as required by 15-31-506, MCA, the Department may assess tax liability as provided by 15-31-544, MCA. The matter was appealed to the First Judicial District Court and on July 23, 2007 the District Court ruled in the Department's favor upholding STAB's findings.

State Tax Appeal Board (STAB):

Barretts Minerals, Inc.: This case involves whether Barretts was a unitary business between 1993 and 2002 and should have been taxed accordingly. The matter is pending before the STAB.

Thompson River Co-Gen (TRC): TRC appealed the Department's determination of value for tax year 2005 at \$18.9 million to Sanders County Tax Appeal Board (CTAB). CTAB found in the Department's favor and did not alter the value determination. TRC appealed to STAB, claiming a value of \$5.2 million. Further, the Department classified TRC as class 13 property, and TRC sought classification as class 4 and class 8. On May 2, 2007, STAB upheld the Department's methodology for determining value (cost approach in this instance), but adjusted the value downward \$1.5 million (for TRC to become compliant with DEQ emissions standards). STAB also found that the Department properly classified the property as class 13. TRC petitioned for judicial review of STAB's decision. Meanwhile, their appeal of 2006 taxes is on hold before the Sanders CTAB, and an informal review of 2007 taxes is anticipated in late September.

PacifiCorp: PacifiCorp advocated for a \$5.04 billion value for its property after the deduction of intangibles. On July 31, 2007, the STAB affirmed the Department's appraisal, and ruled in favor of the Department on all claims in the 2005 case. The STAB specifically determined that the Department's direct capitalization approach is a proper methodology and that there is not error in the Department's direct capitalization approach. The Board also determined that no economic obsolescence existed, and that the post-lien date sale of PacifiCorp for \$9.4 billion validates the reasonableness of the Department's valuation of \$7.1 billion. The 2006 PacifiCorp case is still in the pleading stages of litigation before the Board.

Douglas Hadnot: This case involves a taxpayer whose land had previously been classified as non-qualified agricultural land. Following the adoption of rules relating to non-qualified agricultural land, the Department determined that Mr. Hadnot's property did not meet the production requirements for non-qualified agricultural status. Mr. Hadnot appealed to the STAB. The STAB held that the Department's rule was arbitrary and ordered that Mr. Hadnot's property be classified as non-qualified agricultural land.

Tobacco Tax: Suzie Sneed and Dianne Shultz: These are the first two tobacco tax decisions from STAB. Sneed was decided January 4, 2007, and Shultz was decided May 9, 2007. Both uphold the Department's implementation of the tobacco tax code (Title 16, Chapter 11, part 1, MCA), as far as the Department issuing tax assessments to Montana citizens for purchases of tobacco products over the internet or through the mail. Three additional cases upholding the internet tobacco purchasers' obligation to pay Montana tobacco tax have been decided by STAB. Deanne Saale, decided August 7, 2007; Constance Philpott, decided August 10, 2007; and Alex and Joanie Cantrell, decided August 15, 2007.

Williston Basin Interstate Pipeline (WBI): WBI recently filed a complaint with the STAB for the 2007 tax year. WBI has brought claims regarding central assessment, classification, equalization, equal protection, commerce clause, and assorted valuation issues.

Steinfeldt: The case involved individual income taxes and the records that are required from the taxpayer. The STAB ruled that the taxpayer has the burden of maintaining proper records in order to substantiate deductions claimed on his/her tax return.

Menholt: (1995-1998 tax years) Individual income tax matter. The STAB granted the Department's motion to dismiss due to the taxpayer's abuse of the discovery process. An appeal has been filed with the Thirteenth Judicial District Court, and briefing should conclude late this fall.

Century Tel: Corporate tax case involving unitary business principle and whether an item of income constitutes business income. Discovery is ongoing.

Glacier Bancorp: Corporate tax case involving whether the taxpayer properly extended the statute of limitations for receiving a refund, and whether it was appropriate to penalize the taxpayer for a late-received quarterly estimated tax payment. Hearing scheduled for December, 2007.

Office of Dispute Resolution (ODR):

Lucky Last Jump (LLJ): LLJ moved to dismiss the Department's liquor license revocation proceeding on numerous grounds, one of which was that the annexation in Great Falls of the airport was flawed, such that LLJ was beyond the 5-mile boundary around the city limits (thus qualifying for a county license). The Department argued that determining the validity of an annexation performed in 1994 was beyond the scope of the Hearing Examiner's authority. On October 20, 2006, the Hearing Examiner disagreed with all of LLJ's grounds for dismissal and denied LLJ's motion. The case is currently on appeal before the First Judicial District Court. The 2007 legislature passed HB300 which made LLJ (and its sister case, Gannon Golf Club) moot, but preventing the Department from utilizing an incorrect affidavit from a city planner as the basis for license revocation. The cases (and petition for review) were dismissed.

City of Baker (City): The city of Baker owns and operates a natural gas well. The Department sought to tax production from the well under the Oil and gas Production Tax statutes (Title 15, Chapter 36, part 3, MCA). The City argued that its property (and thus the well production) is exempt under 15-6-201(1)(a)(ii), MCA. On January 12, 2007, the Office of Dispute Resolution's (ODR) Hearing Examiner found in the Department's favor. The 2007 legislature overruled the decision by enacting House Bill 778, which amended 15-36-305, MCA, retroactive to December 31, 1995, to clarify that an interest in production owned by the state or a local government is exempt from taxation under that section.

Smith: The case involved individual income taxes. The ODR ruled that the taxpayer missed the statute of limitations, by over three years, for a refund or monies seized by the Department. The taxpayer filed an appeal to STAB on July 31, 2007.