

# MONTANA TAXPAYER



MONTANA TAXPAYERS ASSOCIATION

HELENA, MONTANA

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## Upcoming Meetings

- March 2 – [ARM 42-2-758](#) relating to gains calculation and voluntary disclosure
- March 6 – [State Admin. & Veterans Affairs](#)
- March 6 – [Legislative Audit Committee](#)
- March 9 -10 - [Legislative Finance](#)
- March 16 – 17 – [EQC](#)
- March 16 – [Montana Rail Service agenda reports](#)
- March 23 – [Law and Justice](#)
- March 24 – [Legislative Council](#)
- April 28 – Revenue and Transportation

For more information and details on these meetings, visit our Calendar on our website at: [www.montax.org](http://www.montax.org)

## ***Revenue and Transportation Interim Committee – Feb 16 and 17***

The committee had a full agenda at their February meeting. Following are some of the agenda items worth noting.

### Limiting access to confidential tax information

The Department of Revenue, Legislative Fiscal Division and Legislative Audit offices have been discussing legislation that would allow employees involved in revenue estimates and audit oversight of the department of revenue more access to confidential tax records. It is our understanding this will not affect the current litigation brought by Senator Jim Elliott requesting the tax records of the top corporations in Montana. There will be no change to the current statute protecting the confidential returns, nor will individual legislators or legislative committees be given access or information on individual records. They may receive, as in the past, aggregate data.

<http://www.montax.org/index.php?pr=Confidentiality>

The agencies are working on proposed legislation and the committee has requested a placeholder for the 2007 Session to allow certain employees access to the confidential records. There will be corresponding penalties if the records are not kept secured and confidential

## General Fund Update – Terry Johnson

Terry Johnson presented the newest figures available through 1/31/06 on the general fund. The Legislature assumed total revenues for FY06 would increase by nearly \$11 million (a 0.76% increase) over FY05 revenues when they adopted in HJ1 in the December Special Session. Recent information on general fund receipts show revenues up by 9.9% from 1/31/05 to 1/31/06. Although many factors could affect this growth pattern, if the trend continues the revenue estimate could be up by \$140 million by the end of the fiscal year.

Mr. Johnson pointed out some of the details in the largest components of the general fund that could swing the final figure in either direction. For individual income taxes, the legislature adopted a lower estimate than actual collections in 2005 due to the effects of SB407 passed during the 2003 Session. They also assumed wage and salary income would grow by 8.4% (recent figures show an actual growth rate of 7.9% or 0.5% below the rate assumed in HJ1). The most recent figures show collections are up 7.8% over last year even with the reduction built in for the effects of SB407. It is still too early to have much certainty since refunds are 48.8% lower than last year (the department is expecting more in February and March), refunds could end up being higher than 2005 due to new withholding tables and taxpayers not making adjustments to their estimated payments due the uncertainty of their ultimate liability under SB407. On the other hand, it is unclear of the positive effects SB407 might have had on increased income activity. Other factors that are having a positive influence are larger capital gains, higher oil and natural gas prices, improvement in net business income and the reduced federal tax rates on dividends continue to produce high corporation dividend payments.

Corporation tax collections are also higher than the revised estimate in HJ1. Collections to date are nearly 74% higher than at this time last year – HJ1 assumed a reduction of 6.9%. Some of the increase is due to large refunds that are anticipated to occur in FY06 that

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Utilities – Tom Ebzery, Billings

have not occurred and the improvement of corporate profits.

Oil and gas collections are also somewhat stronger. HJ1 assumed a growth rate of nearly 59% over 2005 and current collections are over 68% higher. Once again, Mr. Johnson urged caution since energy prices continue to fluctuate.

In conclusion, revenue projections could exceed the estimate in HJ1 if these trends remain strong. However, even if the state ends up with a higher ending fund balance than the estimated \$228 million adopted during the Special Session, it is important to look at estimated ongoing revenues and expenditures to establish a structural balance and consider any additional money as one time.

### Explanation of Business and Corporation taxes

Joe Shevlin, JCCS, and Mike Green, Crawley Law Firm, gave an overview of the current taxation of businesses and corporations in Montana. Mr. Shevlin described the benefits of organizing as pass through type entities such as Sub S, LLCs LLPs, etc. There continues to be an increase in companies choosing this type of election than the historical C corporations due to limits on liability, tax treatment and less legal requirements that govern corporations (including annual reports, director meetings, shareholder requirements and so on). Montana clarified the taxation on nonresident partners or shareholders (HB143, 2001) for compliance purposes. The bill provided for the option of: filing a written agreement to timely file, pay and subject to personal jurisdiction; file a composite return with payment for

participating members or require backup withholding for non-participating or non-agreeing members.

Mike Green commented on issues that continue to create uncertainty and different conclusions for corporations including: the need for a worldwide combined reporting statute; need for definition of worldwide income; refinement of apportionable vs. allocable income (in particular as it relates to business and non-business income); inadequacies of the 3 factor apportionment factor (no national uniformity, undermines the primary goal of UDIPTA and creates a substantial risk of double tax); and the unintended consequences of the litigation on confidentiality of corporate tax records (note: the case is currently under appeal to the Montana Supreme Court – there has been no classification order issued. Classification is where the Court decides whether the case will be decided on the briefs by a five justice panel or by the full court after oral argument).

### Top 5 Business Income Issues – Dan Bucks, Director of Revenue (attached)

The director covered the top concerns of the department on compliance: abusive tax shelters; corporate tax loopholes (REITS, insurance stuffing, international transfer pricing problems); trusts (use of trusts to hide income and MT statutes do not clearly specify which trusts must file Montana returns); unreported income earned in Montana (non-resident sales and exchanges of property, non-resident rents and royalties, nexus investigations); pass through entities (improper use of pass through entities to hide income such as back channel S corporation payments and non-conformity with changed federal tax provisions).

### HJR44- Study of property taxation of oil and natural gas property

The committee is reviewing the current valuation and classification of natural gas and oil production property. The department has been involved in litigation with various companies for nearly five years on the classification of the property. Company officials involved in oil and gas production explained their operations to the committee, in particular the movement of the products from the well head to the distribution site. Jeff Martin gave an overview of how other states classify and value similar properties. The report should be on the legislative web site sometime next week. [http://www.leg.state.mt.us/css/committees/interim/2005\\_2006/rev\\_trans/default.asp](http://www.leg.state.mt.us/css/committees/interim/2005_2006/rev_trans/default.asp) Jeff Martin pointed out the committee needs to consider to what extent central assessment or unit valuation should be part of the equation (v. local assessment); could the market or operating structure determine classification and the department's desire that any proposal minimizes the economic impact to local government.

Lee Heiman, staff attorney, gave an overview of the summary judgment in *Omimex vs. DOR* <http://www.montax.org/index.php?pr=RATIC> Judge Sherlock did not grant the request for summary judgment as he would like the parties to present more factual matters. A trial has been scheduled for September 18 in the Lewis and Clark District Court.

Factually it was noted there were five separate sets of pipeline property that used to be physically tied to MPC's transmission lines before MPC sold the properties. In some cases the lines cross county and international borders. The gas is sold to one customer but transmitted through one of three third-party transmission lines to the customer.

The court said the case was not appropriate for summary judgment because more facts were necessary.

1. The Judge discussed power generation and line interconnection case of STAB where the interconnect between two companies gave the generation company the same status as if it owned the lines. Here there are the three transmission companies and the Court was unsure how the Omimex property operates.
2. There was disagreement between witnesses, who were on affidavit, so the court wanted to hear the witnesses.
3. The Court wants an adequate grasp of what constitutes all the various properties owned by Omimex. What part or all qualifies for central assessment (and how does that tie to unitary ownership?).

The Judge dismissed the commerce clause argument because it wasn't pursued. The court denied property equalization and equal protection arguments because of plaintiffs failure to carry the burden. He indicated he needs facts.

Members of the industry will be putting together a proposal for the department and the committee to consider by March 17. There will be a report back to the committee at the April 28 meeting.

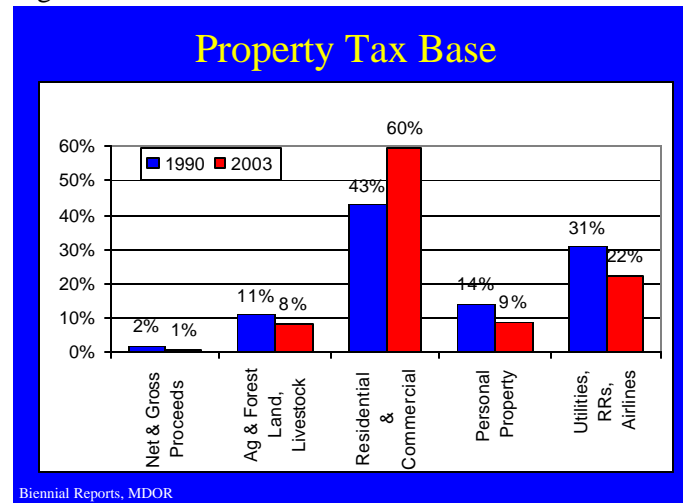
At the next meeting there will also be new revenue updates, information from the Department of Transportation, and an update on the 2009 reappraisal. The committee could also review draft legislation on sharing of confidential

**Observations– on Montana’s Tax System**

A statement heard over and over the past decade is that tax cuts implemented during this time frame shifted the burden of property taxes on to residential and small commercial real property. Professor Doug Young, Montana State University, first presented his analysis of this shift at the Montanan Taxpayer Association’s 2004 Annual meeting and more recently at the Montana Chamber of Commerce’s Business Days at the Capitol.

No on disputes that one of the most dramatic changes in recent years has been in Montana’s property tax base. Residential and commercial property is now over 60 percent of the state-wide property tax base, up from 43 percent in tax year 1990 (Figure 1). Thus, residential and commercial property pays over half the total taxes for the 101 mills levied state-wide for schools and the university system. The shares of the other classes have shown a corresponding decline.

Figure 1

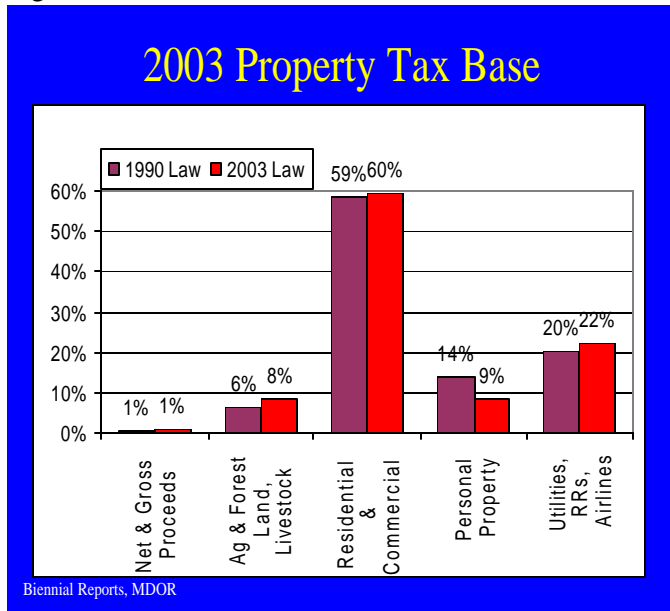


*This “shift” in the property tax burden has resulted from two major factors: changes in property tax laws, and changes in the economy. Among the legal changes, the taxable value rate for most business equipment dropped from 9 percent to 3 percent, electrical generation and telecommunications equipment dropped from 12 percent to 6 percent as part of the process of deregulation, and livestock dropped from 4 percent to zero. The taxable value rate for residential and commercial property fell from 3.86 percent to 3.37 percent, and 31 percent of the value of residential property is now exempted from tax (13 percent for commercial property).*

Changes in the economy also affected the tax base. Substantial migration to Western Montana resulted in new construction and rapidly rising property values, which would have increased the residential and commercial share even if the laws hadn’t changed. Figure 2 illustrates this idea: The appraised value of property in 2003 is used to compute the property tax base under 1990 law; i.e. what the 2003 property tax base would have been if there had been no changes in the law.

The striking feature of the chart is that residential and commercial property would have grown to 59 percent of the tax base even if the law had not changed. That is, most of the shift in the property tax burden has resulted from changes in the economy itself – specifically the growth of residential and commercial property – not from changes in the law.

Figure 2



Even this analysis understates the growth of residential and commercial property, because increases in prices between 1996 and 2002 are only gradually being phased in. Thus, the figures above for 2003 are actually based on prices corresponding to about 1997! If residential and commercial property were taxed on the basis of current market value as was the case at least in principle in 1990, the purple line (“1990 law”) would be even higher than the red one (“2003 law”). In other words, if property tax laws had remained unchanged for the last 15 years and reappraisals were fully reflected in assessed values, residential and commercial property’s share of the tax base would be even greater than 60%.

The cut in personal property taxes shows up as a reduction in its share by 5 percentage points. This had to be made up elsewhere, and agriculture picked up 2 points, residential and commercial 1, and utilities, railroads and airlines the other 2. However, agricultural equipment is about one-fifth of personal property, so agriculture benefited from that reduction as well.

*Source: Douglas J. Young Professor of Economics, Montana State University Bozeman, MT*

### LAWS – 2007

The web site for the 2007 Session is now available. As of February 24, sixty-four bill requests have been received. Many of the requests deal with the public retirement systems, there are already four placeholders on school funding, and miscellaneous interim committee bill placeholders. The 2007 Regular Session is scheduled to begin on January 3, 2007.

<http://www.leg.state.mt.us/css/sessions/60th/default.asp>

### Update on Department of Revenue Rules

Next month’s newsletter will cover the two rule hearings on Montana source income.

### Quote:

The nation should have a tax system that looks like someone designed it on purpose. ~William Simon