# MONTANA TAXPAYER

MONTANA TAXPAYERS ASSOCIATION HELENA, MONTANA

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**Upcoming Meetings**

June 28 & 29 - EQC
June 29 – Education & Local Government
July 10 & 11– Water Policy
July 10 – Energy & Telecommunications
July 12 – Rule Hearing – 42-2-775
July 13 – Law & Justice
August 16 & 17 – Water Policy
August 23 – Rail Service Competition Council
September 20 – Revenue and Transportation
December 6 – Montax Annual Meeting

## Fiscal Report for the 2009 Biennium

(Source: Legislative Fiscal Report2009 Biennium)

The Fiscal Report is now available online on the Legislative Fiscal Division's website. The Fiscal Report contains information regarding the actions of the 2007 Legislative Session(s) and the fiscal status of the state through the 2009 biennium. There are four volumes:

Volume 1: Executive summary, an overview of the final budget and a summary of significant fiscal issues that may have to be addressed during the interim or by the next Legislature.

Volume 2: includes a summary and overview of the state's major revenue sources.

Volumes 3 and 4: Describe the agencies from all three branches of state government, as well as each program within an agency. The agency's appropriations are described as well as present law adjustments, new proposal, new legislation and significant fiscal issues by agency as identified by the Legislative Fiscal Division.

*2009 Biennium Budget Overview*

Montana saw a dramatic turnaround in key revenue sources this last biennium and the 2007 Legislature began with a projected ending fund balance of nearly $1 billion. Although the fund balance at the end of 2009 is expected to be nearly $184 million (after legislative actions), there are issues legislators and Montana taxpayers should be aware of when evaluating the approved expenditures for the 2009 biennium.

- There is a significant expansion of state programs and services.
- The ongoing transfer of funds from the general fund to other funds for a specific purpose reduces future legislative oversight of those general fund moneys.
- There are issues with regard to measurable goals and objectives for the budget increases requested. Further, the Governor line-item vetoed the legislative initiative to require updates on achievement of budget performance measures (accountability) from most agencies.
- The highways special revenue account fund balance is not sustainable in the long term, and future federal funding levels for highways is uncertain.
- The State Fund "old fund" is under funded and will eventually have to be supported by general fund.
- Legislators need to be aware of pending lawsuits related to the State Fund, lease payments by dam owners, and protested taxes that all have general fund implications.
- The long-term stability of the general fund is an issue that must be examined for development of sound fiscal policies.
- Regarding the state's reliance on federal funds, the prospect for federal funding freezes or reductions is a real possibility, not only in the near-term but also in the long-term.
  Regarding wildfire suppression, there are two issues: 1) the cost of suppression operations has increased dramatically; and 2) federal participation is declining. Further, the legislature does not budget up-front for these costs.

In our May newsletter we discussed the overall growth in the general fund (24.9%) and the growth rates of the various agencies. The issues laid out by the Fiscal Division should be a reminder of what growth will actually be sustainable.

# Montana Taxpayer

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*Economic and General Fund Overview*

Montana's economy is expected to stay strong, but revenue growth might not be as high as experienced in the last biennium. Montana does have a healthy fund balance and the budget is structurally balanced (ongoing revenues equal or exceed ongoing expenses). The structural balance is expected to be $146 million at the end of the biennium. If revenues come in higher than expected over the biennium it would be prudent to consider it one-time money for the 2011 Biennium. As the Fiscal Division points out, there are "potholes" that could be troublesome as the state moves toward the next biennium: i.e., potential public school lawsuit, increased costs of the phased-in employee pay proposal, rising corrections populations and continued double digit medical inflation coupled with the potential reduction in federal Medicaid.

*"Structural balance depends on the ability of ongoing revenue to meet anticipated present law disbursement costs. If average revenue growth is in the range of 3.5 to 4.5 percent per year, then the costs of present law services cannot exceed this amount. If additional present law costs or any new proposals are required, then tax policy modifications and/or an adjustment of services provided will be required."*

**DOR Participation with MTC on Voluntary Compliance Initiative**

Many of the proposed bills from both the 2007 Regular and Special Session contained language to allow the department of revenue to implement a Voluntary Compliance Initiative (VCI). The initiative would allow the DOR to waive the penalty and ½ the interest for taxpayers who participated in illegal tax schemes in exchange for giving up their appeal rights. While we supported the concept in general, we took exception to the ability of the DOR to develop rules that could be inconsistent with the IRS. The IRS and the courts ultimately decide whether a tax transaction is illegal. Requiring taxpayers to forgo their appeal rights while a matter is being reviewed is simply bad tax policy.

Recently, we learned the Department already entered into an agreement with the Multistate Tax Commission (MTC) to participate in a VCI program. In fact the director signed on to the agreement on April 2. Not once during any of the hearings or testimony regarding a VCI in either the Regular of Special Session did the department indicate they were planning on implementing the program regardless of the outcome of the legislative process.

The department has agreed to the following:

In consideration for a Participating Taxpayer's participation in this Multi-state VCP, this state will waive or abate only the following penalties that could otherwise be assessed against that Participating Taxpayer with respect to its participation in the Tax Shelters for the tax years listed on its submitted Forms 8886 and accompanying State returns. A penalty is not waived or abated unless listed below:

*If Senate Bill 220 of the 2007 Montana Legislature becomes law and includes additional disclosure penalties, Montana will waive all standard penalties and ½ of the interest from May 1, 2007 through August 31, 2007 and only the disclosure penalties included in SB220 from September 1, 2007 through October 31, 2007. If Senate Bill 220 does not become law, Montana will waive all standard penalties and ½ the interest from May 1, 2007 through October 31, 2007.*

Interesting, after an editorial by Representative Bill Nooney appeared in the *Missoulian*, a new link appeared on the Department of Revenue's website regarding the VCI program. The link goes to the MTC website that contains the press release and application process.

> "The MTC's program will provide a single point of contact and uniform procedure for taxpayers to report abusive tax shelters," said Joe Huddleston, executive director of the Multistate Tax Commission. "The advantage of this program is that taxpayers can avoid costly penalties if they report the shelters during this period."
>
> The program will run from May 1, 2007 to October 1, 2007 in participating states.
>
> Taxpayers who filed returns for any tax periods beginning before January 1, 2006 using abusive

tax shelters may participate in the program. Taxpayers who have not filed tax returns because of abusive tax shelters also may participate. Depending upon individual circumstances, a taxpayer will file an amended tax return or an original tax return with the MTC. The commission will distribute the returns to the appropriate states.

There is an application available on the MTC website. The list of participating states is also listed. You can click on each state to see the conditions of participating in the program.

Our association takes no position on whether taxpayers should participate or not in the VCI program. We do believe the Department should have made this information public knowledge in April. At a minimum, the Department should adequately inform the taxpayers of Montana about the program.

**Revenue and Transportation Interim Committee**

The committee failed to elect a chair for the 2009 Biennium at their June 21 meeting. Typically, the position changes from one party to the next and alternates between the Senate and the House. That would have resulted in the election of Representative Bob Lake as chair of the committee. The committee will reconsider its actions at their next meeting in September. It appears this committee could be heading straight back to the party politics we saw during the last interim.

*$400 Rebate*

The department laid out their plans for implementation of the $400 rebate for property owners. They intend to mail approximately 300,000 pre-populated forms on August 22. They will be providing public outreach prior to the mailing using multiple media and including some public and private sectors. A toll free number will be activated on August 1. There will also be web filing available and the ability to print blank forms. They intend to begin processing the refunds by September 1. The deadline to file is December 31 and the department's authority to pay claims expires June 30, 2008.

The department filed proposed administrative rules on June 21. The hearing will be July 12 at 1:00pm. The rules clarify the time frame homeowners must live in their home to qualify for the rebate. If you moved and re-purchased or just purchased a home in 2006, the total time must add up to seven months.

*2009 Reappraisal*

In 2009, the Department of Revenue's Property Assessment Division will have completed their seventh reappraisal cycle. With each cycle, the legislature has reduced the tax rate (from 12% in 1972 to 3.01% when this cycle ends in 2008) and implemented other measures to keep the values revenue neutral statewide. This assures that that taxes on Class 4 (residential and commercial real property), Class 3 (ag land) and Class 10 (forest land) remain relatively the same as they were before the reappraisal.

During the interims before reappraisals, the Revenue and Transportation Interim Committee typically reviews the progress and examines ways to mitigate any large increases in values. This cycle HB488 carried by Representative Jopek directs the committee to evaluate the changes in market value and then consider strategies to mitigate the effects of changes in revaluation.

Other measures Legislatures have used to mitigate increases in value as a result of prior reappraisals include a property tax assistance program (1979); a property tax credit for the elderly (1986); phasing in the increases while reducing rates (1997); homestead and comstead exemptions (1997); and an extended property tax assistance program in 2003.

The Property Assessment Division has already started the process for implementing the reappraisal. They intend to have initial final values ready for review by October of 2008. This will allow the committee, the administration and other legislators the opportunity to examine methods for the final implementation.

**Legislative Finance Committee**

Senator Trudi Schmidt was elected chair. She appointed a Management Advisory Workgroup that will meet with the chair and staff on certain bulldog issues. The work group includes: Reps. Jon Sesso and Rick Ripley, Sens. John Cobb and Carol Williams.

The proposed workplan was presented to the committee and there was considerable discussion on which projects the committee would tackle. While this list is still being finalized, the following topics will likely be discussed:

Study of budget and appropriations processes of the State of Montana including a review of statutory appropriations and transfers. Subcommittee: Sens. Wanzenried and Cobb, Reps. Sesso and Taylor.

State Government Budget Model. A long term assessment of state Budget Expenditure/Revenue structure. Will keep the Revenue and Transportation Committee apprized. Subcommittee: Rep. Erickson and Sen. Bales.

Examination/Revision of Legislative Fiscal Division products and services: Bulldog*: Management Advisory Workgroup.

Study of Federal Medicaid Reimbursement for Tribal Services. Bulldog*: Sens. Williams and Cobb.

Performance management options. Each member of the Joint Appropriations Subcommittee will monitor the goals and objectives presented by the agencies during the session. Bulldog*: Sen. Cobb.

The graying of Montana: Effect of State Govt. workforce, revenues and expenditures. Will work closely with the subcommittee on State Govt. Budget Model. Bulldog*: Sen. Williams and Rep. Heinert.

*Bulldog groups do not have to post notices.

**Business Associations play a Role in Policing their Industry**

When it was discovered that a handful of financial intermediaries were caught up in unscrupulous practices connected to tax-free 1031 exchanges, the Federation of Exchange Administrators (FEA) stepped up to the plate to weed these firms out of the industry. The FEA was organized to represent professionals who conduct like-kind exchanges under Internal Revenue Code §1031 and the interests of the consumers who use their services. FEA members include: Qualified Intermediaries (QIs), their primary tax and legal counsel, and affiliated industries (Tenant-in-Common sponsors, banks, real estate brokers, title companies settlement/escrow agents, etc). FEA members are held to the highest level of professional standards. Approval of membership requires an extensive background check and screening.

The role of a QI is to acquire, hold and convey both the relinquished property and the replacement property, prepare the required documentation and control the exchange proceeds. The QI provides the closing agent/escrow officer with instructions, ensures the conveyance documentation properly reflects an exchange, and keeps the taxpayer aware of time deadlines. The QI also provides guidance to the taxpayer and taxpayer's agents and professional advisors and is available to answer questions throughout the exchange process.

Most 1031 exchanges are facilitated by upstanding QI companies, but some firms have engaged in practices that are counter to best practices and the Code of Ethics adopted by the FEA and most QIs. Those undesirable practices include commingling funds with other business accounts of the QI company or its principals and improper accounting for exchange funds. In response to these practices, FEA has been working with state and federal regulators to educate consumers and to hold QIs to a code of ethics that will help to prevent future misdealings.

The FEA recently spent countless hours working with lawmakers in Nevada in the passage of Nevada SB476, which revised the Nevada regulations that were the first in the nation to regulate QIs. The FEA is also working with legislatures of others states in a similar fashion, with the goal of protecting consumers' interests in regards to the 1031 exchange industry.

The FEA will be working with Montana legislators on potential legislation to ensure Montana adopts similar regulations. There are always pros and cons to increased regulation, but when legislation is drafted with consistency from state to state, the result is better consumer protection with minimal additional costs.