

MINUTES

**MONTANA SENATE
57th LEGISLATURE - REGULAR SESSION
COMMITTEE ON TAXATION**

Call to Order: By **CHAIRMAN BOB DEPRATU**, on March 16, 2001 at 8:00 A.M., in Room 405 Capitol.

ROLL CALL

Members Present:

Sen. Bob DePratu, Chairman (R)
Sen. Alvin Ellis Jr., Vice Chairman (R)
Sen. John C. Bohlinger (R)
Sen. Mack Cole (R)
Sen. Pete Ekegren (R)
Sen. Jon Ellingson (D)
Sen. Bill Glaser (R)

Members Excused: Sen. Dan Harrington (D)
Sen. Emily Stonington (D)

Members Absent: None.

Staff Present: Lee Heiman, Legislative Branch
Deb Thompson, Committee Secretary

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

Committee Business Summary:

Hearing(s) & Date(s) Posted: Senate Bill 493, 3/2/2001;
Senate Bill 495, 3/2/2001
Executive Action: Senate Bill 350 Pass 8-1 as amended

HEARING ON SENATE BILL 493

Sponsor: SENATOR FRED THOMAS, SD 31, Stevensville

Proponents: Linda McCulloch, Superintendent of Public Instruction; Bob Brown, Secretary of State; Mike Foster, Representing Governor Martz; Carroll South, Executive Director of the Board of Investments; Jason Billman, Chief Deputy Secretary of State; Dick Croft, Commissioner of Higher Education; Dustin

Stewart, Associated Students; Marcie Mercer, Investment Advisor for Merrill Lynch; Sarah Cobler, Student Lobbyist for University of Montana Dillon; Webb Brown, Montana Chamber of Commerce; Mary Whittinghill, Montana Taxpayer Association; Bob Colville, Montana School Board Association; Dave Puyer, MREA; Eric Feaver, MEA-MFT

Opponents: None

Opening Statement by Sponsor: SENATOR THOMAS presented the bill. He explained SB 493 and SB 495 would work together to accomplish goals. SB 493 would put an amendment on the ballot to remove the restrictive way money in the school trust fund could be invested. SB 493 would allow the Board of Investments to invest small portions in private corporate stock which would produce greater revenue streams in the form of capital gains. There is strong evidence that significant revenue to schools with little risk would be gained. He pointed out the investment advice for a diversified portfolio and a safer, stronger portfolio. A Nobel Prize winning economist, Harry Markowitz, proved this with a study he conducted in 1990. He found that in the past 70 years, including the Great Depression, a portfolio consisting in 15% invested in stocks and 85% in bonds had less risk than a portfolio of 100% invested in bonds. In the same period of time, government and corporate bonds had yielded a little more than 6% a year. Large company stocks had yielded more than 11% in that same time frame. Other Western states do this. The State Fund is already investing in the stock market and the state already invests its retirement funds for public employees and teachers in equities as well as bonds. This makes the School Trust Fund work harder. It will also include the Coal Tax Trust Fund as far as investments. It would allow growth in both of those funds.
{Tape : 1; Side : A; Approx. Time Counter : 0 - 9.6}

Proponents' Testimony: Linda McCulloch, Superintendent of Public Instruction, spoke in support of the bill. She distributed written testimony. **EXHIBIT (tas60a01)**

Bob Brown, Secretary of State and member of the Land Board, said there was a need to maximize investments and it was time to examine the trust. He pointed out the Board of Investments had been limited on how they could invest funds and had only been able to invest in bonds. He noted that the growth rate in the fund had been very slow and support for public education had grown at a very slow rate as well. The trust lands were given to Montana by the federal government for the purpose of supporting the public schools. The trust could be made to work harder and more productive for the school children of Montana. This same issue was put on the ballot in 1982 and was not approved. That was unfortunate because if this same concept had passed in 1972

at a time when the stock market was down, if it had been invested then, there would be \$23-24 million dollars more. This bill is a long term approach to education funding. **{Tape : 1; Side : A; Approx. Time Counter : 12.3 - 17.7}**

Mike Foster, representing **Governor Martz**, testified in support of the bill. The term "prudently invest" described the Board of Investments who were capable of making very good decisions on how to invest the funds in the trusts. The benefits have been spelled out and there are better ways to finance education. Everyone stands to benefit from this. He urged the committee support the bill. **{Tape : 1; Side : A; Approx. Time Counter : 17.7 - 18.9}**

Carroll South, Executive Director of the Board of Investments, spoke in support of the bill. He told the committee that the Board of Investments had been investing pension funds in stocks since 1976. During that period of time, they have also been investing the pension funds in bonds. He described the scenario of 50% invested in stocks and 50% invested in bonds. The outcome of that scenario showed hundreds of millions of dollars gained in stocks. In order for this to work, the capital gains had to be reinvested. It has been documented since 1926 that stocks over a long period of time will outperform bonds. He said there were only two safe investments - those being FDIC insured \$100,000 in the bank, the other is the U.S. Treasury Bond or a bond backed by the U.S. Government. Those are yielding 5-5 ½%. The board would take a cautious approach by investing the School Trust in January, 2003. They would ask for guidance in the next Session of the Legislature as to what the maximum amount should be. **{Tape : 1; Side : A; Approx. Time Counter : 18.9 - 23.2}**

Jason Thielman, Chief Deputy Secretary of State, gave some background on the Education Trust Fund which began in 1889. He gave a Power Point presentation. He pointed out the current methodology and what would help maximize the earnings of the trust. If 25% had been invested in equities the value of the trust would have doubled in value. **{Tape : 1; Side : A; Approx. Time Counter : 23.2 - 30}**

Dick Crofts, Commissioner of Higher Education, said the flexibility would be helpful to the education community. He supported the bill and the election process. **{Tape : 1; Side : B; Approx. Time Counter : 0 - 1.9}**

Dustin Stewert, student representative, said this long term proposal was important. He pointed out tuition had increased 102% and they were asking students to pay an additional 9% tuition increase for each of the next two years. Bright students

would have to drop out of college because they could not afford to pay more. **{Tape : 1; Side : B; Approx. Time Counter : 1.9 - 6.7}**

Marcie Mercer, a native of Absarokee, Montana, an investment advisor for Merrill Lynch, gave some examples of her experience with stocks. She felt if money was managed better it would mean less taxes on the citizens. **{Tape : 1; Side : B; Approx. Time Counter : 6.7 - 7.6}**

Sarah Cobler, representing the students from the University of Montana in Missoula and the University of Montana Western in Dillon, voiced her support for the proposal.

Webb Brown, Montana Chamber of Commerce, supported the bill as an innovative piece of legislation.

Mary Whittinghill, Montana Taxpayer Association, supported the bill fully.

Bob Colville, Montana School Board Association, stated there was a need to increase performance in the trusts.

Dave Puyer, Montana Rural Education Association, said their association was in strong support for the bill. Everyone felt higher education should be a higher priority.

Eric Feaver, MEA-MFT, supported the bill.

Opponents' Testimony: None

Informational Testimony: **Elaine Herman**, registered Investment Advisor, shared information about recent articles in the newspaper. She described her licensing. She informed the committee that no one could deny the long term investment provisions throughout history would provide us with a higher income than bonds. The SEC was very strict and meant business. One of their laws is when an Investment Advisor tries to sell someone on investment advise - there is a requirement to say that "past performance is no indication of the future". A long term investment means more than five years. Pension funds are twenty year investments. **EXHIBIT(tas60a02) EXHIBIT(tas60a03)** She described a two year chart and a ten year chart of the indexes. **{Tape : 1; Side : B; Approx. Time Counter : 7.6 - 19}**

Questions from Committee Members and Responses: **SENATOR BOHLINGER** commented that a longer perspective was needed when considering equities. He felt the proposal was bold but worthwhile.

SENATOR ELLINGSON asked **Carroll South** about the Coal Tax Trust Fund and where the reference was in the bill. **Mr. South** replied the reason that no other state funds could be invested in equities was because of language being stricken - which included every other state fund. Once that is taken out, there are no restrictions. **SENATOR ELLINGSON** asked how the income was calculated if a portion was invested in equities, when regarding dividends or capital gains and losses. **Mr. South** replied there were two investment vehicles. One was a common stock pool, a mutual fund in which the dividends were distributed. That was created in 1981 - though they never distribute capital gains. That is why pensions have done so well. You do not want to lose the compounding effect. The recommendation by the Board of Investments, if you are going to invest the School Trust in capital stocks, do it immediately in a package that will give you a piece of the 500 largest companies in the country which is the S&P 500. They are using Barclays Global Investment to do that and they do not distribute dividends nor do they distribute capital gains. This is a long term plan, not in the next three or four years. Someone will have to determine how much of the trust should be invested in stocks. That decision does not have to be made now. Here is how it would work - that part of the stock that is invested in stocks would continue to increase in value until it has reached whatever percent should be in the trust. At that point, if the growth in equities is better than the growth in fixed income, you make a decision to start selling units in the pool because you are at 25%. That is when you take out your profits. Until you do that, it is paper profits and paper loss. You need to make sure you do not allocate too much to the trust for equities. **SENATOR ELLINGSON** asked if this meant the capital gains are put back into the investment vehicles. **Mr. South** replied the S&P 500 does not distribute dividends and that is where they recommend where the investments are placed. Once you start selling then it is considered income. *{Tape : 1; Side : B; Approx. Time Counter : 19 - 25.8}*

Closing by Sponsor: **SENATOR THOMAS** closed. He felt this was a good move forward. He pointed out this would work well in the retirement system and it would work well in the state fund. He stated it was time to invest the education funds more wisely. This will provide for a dramatic funding increase for schools. *{Tape : 2; Side : A; Approx. Time Counter : 0 - 12}*

HEARING ON SENATE BILL 495

Sponsor: **SENATOR FRED THOMAS**, SD 31, Stevensville

Proponents: Linda McCulloch, Superintendent of Public Instruction; Bob Brown, Secretary of State; Jason Thielman, Deputy Secretary of State; Dustin Stewert, Associated Students; Webb Brown, Montana Chamber of Commerce; Erik Feaver, MEA, MFT; Mary Whittinghill, Montana Taxpayer Association; Dave Puyer, MRTA

Opponents: None

Opening Statement by Sponsor: SENATOR THOMAS presented the bill. He said the bill would help solve funding problems right now. They expect this to generate \$7-10 million dollars for the School Trust Fund this year and next. It will produce an increasing stream of revenue in future years which would then be distributed to the schools. It does this by authorizing an irrevocable loan of no more than \$100 million dollars from the Coal Tax Trust Fund so that a newly created fund called a Guaranteed Account can purchase mineral royalties from the State Land Board. These royalties would then be used first to pay back the loan to the Coal Trust. Then they will be used to reimburse the General Fund for any interest income loss from the loan. Any additional royalties will remain in the Guarantee Account where they will be available for distribution for the schools. **{Tape : 2; Side : A; Approx. Time Counter : 12 - 16}**

Proponents' Testimony: Superintendent Linda McCulloch distributed written testimony in support of the bill. **EXHIBIT (tas60a04)** **{Tape : 2; Side : A; Approx. Time Counter : 16 - 23.3}**

Secretary of State Bob Brown, testified in support of the bill. He stated this would solve school funding without raising taxes and could be used in the near term to pay expenses for education. **{Tape : 2; Side : A; Approx. Time Counter : 23.3 - 25}**

Jason Thielman, Deputy Secretary of State, described how the mineral royalties would flow into the funds. **EXHIBIT (tas60a05)** He distributed a chart of the proposed distribution of revenue. **EXHIBIT (tas60a06)** He noted SB 495 would not affect the General Fund, would provide more money to schools and would repay the Coal Tax Trust Fund. **{Tape : 2; Side : A; Approx. Time Counter : 25 - 30}**

Dustin Stewert, representing the Associated Students, said the bill provided funds for school districts in the short term.

Bob Vogel, representing the Montana School Board Association, supported the bill and stressed the importance of short term funds for education.

Webb Brown, Montana Chamber of Commerce, urged support from the committee.

Erik Feaver, MEA-MFT, expressed cautious support. He felt the bill was good and necessary.

Mary Whittinghill, Montana Taxpayer Association, supported the concept. She felt it would be a better utilization of current funding.

Dave Puyer, Montana Rural Education Association, supported the bill.

Opponents' Testimony: None

Questions from Committee Members and Responses: **SENATOR ELLINGSON** asked what were the statutory requirements that now prevented these funds from going directly to schools. **Janice Doggett**, legal counsel for the Secretary of State's Office, replied the trust and legacy fund was inviolate and that is why the loan pays fair market value to the fund to make it whole. Those mineral royalties are extracted from that and the money can then be allowed to be diverted to schools. Constitutionally, 95% of the income is designated to the trust and 5% comes out. **Jason Thielman** clarified that mineral royalties were not considered income. Taking the mineral royalties from the trust is considered a permanent disposition of the trust. That goes back to the enabling act and a 1972 court case which interpreted this issue. The reason a lump sum is needed to be put into the Education Trust is to determine the fair market value to make sure you are not making a permanent disposition. After that lump sum payment has been made, there is a fair right to that royalty stream. **SENATOR ELLINGSON** asked about the \$13 million dollars that might be available. **Mr. Thielman** replied that was a net after all the obligations were paid. That was additional money available to states. The gross number was \$21.5 million dollars that comes to the Education Trust to Schools. **{Tape : 2; Side : B; Approx. Time Counter : 0 - 12}**

SENATOR ELLINGSON asked where the bill addressed the authorization of the loan from the Coal Tax Trust Fund. **Mr. Thielman** said that language plus the amendments by **Greg Petesch** should be considered.

Closing by Sponsor: **SENATOR THOMAS** closed. He noted the bill would provide for the best use of the assets for the children.

EXECUTIVE ACTION ON SENATE BILL 350**SENATOR ELLINGSON MOVED DO PASS AND MOVED THE AMENDMENT**

#035005.alh. EXHIBIT (tas60a07) He explained the bill would address low income housing and it would be a good idea to fund charitable endowments to provide a credit for this purpose. The amendment would tighten up the type of corporations that would be eligible to receive the credit. It would clarify the Revolving Loan Account which would be eligible to receive planned gifts in the same manner that the community endowments can receive those gifts. He pointed out the sunset is in four years to allow time to study what this would cost the state. *{Tape : 2; Side : B; Approx. Time Counter : 19.9 - 25.1}*

The question was called on the amendment. The amendment was **ADOPTED** 9-0.

SENATOR ELLINGSON pointed out the need for low income housing. He said housing was a key to stability and it was a very important program.

The question was called on the bill as amended. The motion **PASSED** 8-1 with **SENATOR GLASER** voting no.

ADJOURNMENT

Adjournment: 9:40 A.M.

SEN. BOB DEPRATU, Chairman

DEB THOMPSON, Secretary

BD/DT

EXHIBIT (tas60aad)