

OUTLINE OF REP. BUTCHER'S TAX REFORM PACKAGE

Residents who file income taxes would receive an exemption for all property taxes—non-residents pay property taxes.

- I. Montana taxpayers can choose whether to pay EITHER income tax or property tax.**
- II. All property taxes eliminated for residents.**
- III. Tax relief for working and fixed income middle class who own property.**
- IV. A sales tax without exemptions—fair and easy to monitor.**
- V. All residents get a direct rebate for 15% of per capital income (2005 would be \$3,800.00 @ 4%= \$155.00) to replace an exemption for sales taxes on food and medicine.**
- VI. All tax surplus at the end of each fiscal year (June 30) would be rebated to each Montana resident (2004 would have been between \$1,000.00 and \$1,500.00 sent each taxpayer by September 1).**
- VII. These are voted Constitutional amendments which can be changed only by a vote of the people so future legislators can not change these provisions.**

PRESENTATION OF HB 408 AND HB 779
Rep Ed Butcher, HD 29

Members of the Tax Committee I would like to introduce these two companion bills which are Constitutional Referendums. In considering tax reform, I ask us to keep in mind that all tax proposals must originate from the precept of fairness. Consequently, it must reflect the honest tax base of a taxing jurisdiction and the ability of those taxed to pay their fair share.

- I. We all tend to review tax policies and proposals from our individual experiences—(i.e.) the frustration of paying income taxes and such.
 - a. Most tax proposals originate from a desire to shift taxes to an economic base which would have less effect on our personal economics.

- II. I am taking a different track—my background is a political science academic who has the additional life experiences as a wage earner, in agriculture, as a corporate executive, small business owner, and for the past sixteen years as a business consultant.
 - A. HB 408 as proposed, with amendments, results from the perspective of a political scientist evaluating our current tax system and addressing the shifting tax base over the past several decades. Based on my research, I am offering a solution to problems I uncovered.
 1. Montana has a large property tax base which is eroded by about 30% government ownership with minimal tax compensation and is largely non-connected to income production and taxpaying ability.
 2. Montana is surrounded by income tax sheltering states which allow Montana residents with fluid assets to elect not to pay the income taxes upon which the state relies heavily.
 3. Montana is a growing recreation “destination” state as well as a seasonal residency location.
 4. Both the seasonal residency component and Montana property being utilized under IRS tax code 1031 for tax sheltering of assets during the shifting of them from one commercial business enterprise to another, has impacted the Montana tax system resulting in significant tax shifting.

- III. The traditional argument for adding a sales tax to the Montana tax structure has centered on the “three legged stool” concept.
 - A. First of all an “ideal” tax system would be a single tax—simple, direct, and easy to administer.
 1. The concept of two and now three base taxes have developed from an effort to have a broader tax base in an attempt to include individuals perceived to be avoiding a specific individual tax.
 2. The dilemma is that significant numbers of innocent individuals can be caught with a disproportionate share of tax burden through payment of all three taxes while other individuals are able to position themselves to pay only one or possibly two of the three.
 - a. The “working middle class” (\$25,000--\$75,000 without significant mobile assets) suffer the most significant tax burden.
 - b. Low income/fixed income property owners have faced the greatest tax penalties in recent years under the present system and are increasingly forced to liquidate their assets and often re-locate or down-scale their living standards.

- IV. HB 408 (with its amendments) and its companion HB 779 are a single tax-reform package divided into two parts in order to address the Supreme Court recommendation of avoiding more than one issue being addressed in a single amendment.
- A. This tax reform package is the result of over three years research on providing an equitable tax structure while addressing the issues raised by traditional opponents of a sale tax such as:
1. **NEXT LEGISLATURE WOULD CHANGE IT OR INCREASE THE TAX:** This reform package is being introduced as a Constitutional Referendum for the voters to approve and could only be changed by the voters.
 2. **MUST ELIMINATE ANOTHER TAX:** (Page 1, Line 23) This proposal would eliminate ALL property taxes for resident income tax filers who requested an exemption.
 - a. County treasurers would total all exempted property taxes and be reimbursed by the Department of Revenue as long as the taxpayer continues to file resident income tax returns.
 - b. All school, road and other local taxes based on property taxes would be "made whole."
 - c. SID's and locally voted bonds would not be exempted since only the property owners themselves can vote these for specific projects.
 3. Montana residents currently can elect to report their income in the state jurisdiction which best supports their tax benefits and this proposal simply provides the same option for Montana residents with non fluid assets.
 - a. This is a truly non-discriminatory tax policy with all Montana taxpayers treated equally.
- B. The most revolutionary part of this legislation is section 1, part 2 (page 1 line 17-20) which rebates tax revenue in excess of the state budget to those filing income tax returns.
 - a. This is pure economic stimulation—by September of a surplus tax year each Montana resident would receive a check to spend (2004 would have resulted in \$1,000.00--\$1,500.00).
- C. (Page 1, Line 27—Page 2, Line 7) This bill provides incentives for Montana based business by allowing for exemptions for all their property taxes on the conditions that their company headquarters are located in Montana and a majority of their stockholders qualify for a property tax exemption.
 - a. An important protection for non-resident property taxpayers so they do not face unfair tax increases (page 2, line 9) limits property tax increases to no more than the cost of living index.
 - b. If a business is leasing their location, both land-lord and tenant must qualify for a property tax exemption.

Now let us review HB 779 which is the second Constitutional Amendment in this tax reform package which would be voided if the provisions under HB 408 are not enacted. After studying a number of tax systems in different states, it became obvious that this, in combination with provisions outlined in HB 408 as amended, is the only approach which is truly fair to all economic segments of the state.

In developing this package, I not only met several times with individuals such as Dr. Natelson, Dave Lewis, Jerry Driscoll, various business leaders (in and out of Montana), but I also spent a lot of time discussing sales tax concerns with working people, farmers, and small businessmen.

It is obvious Montana will eventually have a sales tax—even if it is a “patch work” of local option taxes, specific sales taxes—all very expensive to manage and punitive to large groups of Montana residents.

- I. This tax proposal has no specific individual exemptions (which is the only fair taxation without continual conflicts over what should be exempted), but does provide for low income concerns by providing for a global rebate of 15% of per capital income for each taxpayer filing a Montana income tax return.
 - a. This addresses the traditional concerns demanding exemptions for food and medicine, but would not require an expensive bureaucracy to monitor compliance.
- A. This proposal avoids “pyramiding” of taxes by restricting the sale tax only to the retail sale of goods and services while exempting wholesale or items which are components of finished retail goods.
- B. Because an estimated 80% of Western Montana real-estate transfers involve IRS 1031 exchanges, this proposed legislation also includes property transfers (this would be the only method to capture some tax from this business which has tended to inflate property values in Montana).
 - a. Because we can not discriminate among classes of taxpayers, all property transfers would be taxed. If a property is purchased for \$200,000 the transition would cost \$208,000 which would not be a deterrent since the purchaser would simply roll the tax into the mortgage.
 - b. A resident qualifying for an exemption of property tax would not pay any additional taxes on that property.
 - c. Under this tax reform package, a property owner would actually own his property and not have a perpetual government lean on it and a government rent payment. Also, a property owner in Montana would no longer face foreclosure and eviction if he failed to pay his perpetual government rental.

Now let us review the fiscal analysis by the Department of Revenue to see how this proposal would affect state revenue. They reviewed the fiscal analysis of the original 2003 proposal and updated it to this slightly revised bill and current economic numbers. Go to page three of the March 3, 2005 D.O.R. which was prepared by Mr. Larry Finch, Administrator Tax Policy and Research, review the net impact to state and local revenue.



Dan Bucks
Director

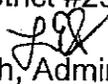
Montana Department of Revenue



Brian Schweitzer
Governor

DATE: March 3, 2005

TO: Representative Ed Butcher
House District #29

FROM:  Larry Finch, Administrator
Tax Policy and Research

SUBJECT: Update Impact of SB186 (2003 Session) (HB 408) (HB 779)

You recently asked for an update of the impact of SB186 from the 2003 legislative session, to include other aspects not incorporated in that bill.

Proposal

This proposal would send a referendum to the voters to amend the State's Constitution to provide for the following general provisions:

- Montana would implement a broad-based retail sales and use tax to include a wide variety of transactions, including the sale of a business. Generally, sales for resale and component parts incorporated in manufactured products would be exempt from the sales tax.
- Individual, corporate, and other business *resident taxpayers* would be subject to the state's individual and corporate income taxes, but would not be required to pay property taxes; *nonresidents* would not pay individual income taxes, but would be required to pay taxes on any property they owned in the state. Specific rules would outline which corporations and businesses qualify as residents.
- Resident taxpayers filing individual income tax forms would be eligible to receive a sales tax rebate based on 15% of per capita personal income.
- The state would reimburse local governments and schools for the amount of property taxes no longer paid by resident income taxpayers.
- Any revenue collected during a biennium in excess of that budgeted by the Legislature would be returned to taxpayers in the form of an individual income tax rebate.

Revenue Impact

Because the revenue impact of this proposal will depend critically on the specifics of legislation that is passed to comport with the above general changes to the Constitution, the following impacts provide a general indication of how revenues might be affected overall.

Sales Tax

Two years ago we estimated the sales and use tax to generate about \$930 million per year. We have not changed that estimate in this analysis. Again, it is very difficult to tell just how much the sales tax would actually generate until such time as specific legislation is passed detailing the tax base for the sales tax.

Nonresident Income Tax

Each year nonresidents contribute somewhere between 6% and 7% of total individual income tax liability. Based on current forecasts of total individual income tax liability it is anticipated that eliminating the requirement for nonresidents to pay individual income tax would reduce general fund revenues by \$37-39 million a year.

Sales Tax Rebate

The total cost of the sales tax rebate will be equal to the per capita amount of sales tax rebate calculated each year multiplied by the number of persons or households claiming the rebate who file individual income tax returns. The general provisions lack specificity regarding this rebate. In particular, it is not clear if the calculated rebate amount would be rebated to each household, or if the rebate amount would be given to each person in the household. This analysis assumes that the rebate amount is provided to each household, regardless of the number of persons in the household.

Based on a forecast of Montana per capita personal income, and assuming 363,967 households will receive the rebate, the total amount of rebate provided increases from \$62.2 million in fiscal 2005, to \$79.4 million in fiscal 2010. The rebate amount would continue to grow each year with growth in per capita personal income.

Eliminate Resident Property Taxes – State Mills and Rebate of Property Taxes to Local Governments and Schools

In tax year 2004, a total of \$914.1 million was paid in property taxes by all taxpayers. Of this amount, we estimate that resident taxpayers and businesses paid \$524.5 million, or about 57.4% of the total. Of this amount, \$422.5 million (80.5%) is property taxes that would have been paid to local governments and schools. This is the amount of revenue that would have been refunded to these taxing jurisdictions in fiscal 2005 under this proposal. Again, this amount will grow each year along with growth in the general property tax base.

Eliminating property tax for residents who pay income taxes will also result in a direct reduction of revenue to the state general fund and university system accounts. The general fund would experience a reduction of \$95.9 million, and the university system a reduction of about \$6 million.

Administrative Impacts

There will be significant administrative costs associated with this proposal. In the 2003 legislative session, the fiscal note for SB186 showed first-year administrative impacts of \$10.5 million; with continued additional costs of about \$4 million each year thereafter.

Costs in the first year include one-time expenditures to implement and administer the new sales tax in the proposal of about \$5 – 6 million.

Net Impact

Based on the above discussion, the estimated net impact to annual revenues would be as follows:

Retails Sales and Use Tax Revenue	\$930,000,000
less: Nonresident individual income taxes	(38,000,000)
Sales tax rebate	(62,200,000)
Property Tax Reduction – General Fund	(95,888,000)
Property Tax Reduction – University System	(6,056,000)
Local government property tax rebate	(422,461,000)
Annual administrative expense	(4,000,000)
Net Impact to Revenue	<u>\$301,395,000</u>

The above impact generally relates to the ongoing impact that would occur in fiscal 2005. The net impact in future years could change if the impacts of the separate components of the proposal grow at different rates.

Nevertheless, it is apparent that the proposal would generate a substantial amount of new revenue. However, as provided for in the proposal, any excess revenue above the amount authorized by the Legislature would be returned to taxpayers in the form of an individual income tax rebate.

Please let me know if we can be of further assistance.

Gray Bill

HOUSE BILL NO. 408 INTRODUCED BY E. BUTCHER

A BILL FOR AN ACT ENTITLED: "AN ACT SUBMITTING TO THE QUALIFIED ELECTORS OF MONTANA AMENDMENTS AN AMENDMENT TO ARTICLE VIII, SECTION 1, ~~AND ARTICLE VIII, SECTION 16~~, OF THE MONTANA CONSTITUTION TO GENERALLY REVISE INCOME AND PROPERTY TAXATION AND ESTABLISH A RETAIL SALES AND USE TAX; PROVIDING FOR REBATES OF EXCESS STATE REVENUE; PROVIDING THAT ONLY STATE RESIDENTS PAY INCOME TAX AND THAT ANY PERSON PAYING INCOME TAX MAY ELECT NOT TO PAY PROPERTY TAXES UNDER CERTAIN CIRCUMSTANCES; ESTABLISHING A RETAIL SALES AND USE TAX WITH A BASE REFUNDABLE AMOUNT; AND PROVIDING AN EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Article VIII, section 1, of The Constitution of the State of Montana is amended to read:

"Section 1. Tax purposes -- rebate of excess tax revenue -- applicability of tax type. (1) Taxes shall be levied by general laws for public purposes.

(2) Each fiscal year, revenue that is received by the state, other than that received from the government of the United States, that is in excess of the amount budgeted by the legislature shall be rebated on a per capita basis to individuals who filed income tax reports for the prior calendar year. The rebate shall be made in the following fiscal year in the manner determined by law.

(3) Retail sales of goods, property, and businesses are subject to the sales tax or use tax as provided in Article VIII, section 16.

(4) (a) The following may be exempted at the owner's request from property taxes under the terms specified in this section, but may not be exempted from special assessments or voted bond obligations:

(i) property owned by an individual and all members of the individual's family filing individually or jointly for each year that the individual files Montana income tax returns;

An individual who files a Montana resident income tax return may request that all property owned in Montana be exempt from property taxation by filing a request with the department of revenue along with a list of the counties in which property is owned. The property tax exemption does not apply to special assessments or voted bond obligations.

(b) (i) To qualify for the exemption in subsection (4) (a), each of the members of the immediate family of the individual, including dependents, shall file a Montana resident income tax return.

(ii) The department shall immediately notify the counties in which the property is located that the property owner has qualified for an exemption.

(iii) Each county shall total the amount of the property tax exemption and notify the department of the total. The department shall reimburse the county for the amount of the exemption.

(c) (i) The property tax exemption in subsection (4) (b) shall continue as long as the property owner qualifies as a Montana resident required to file income taxes. If a qualified individual fails to file a resident income tax return by April 15 of a tax year, the individual does not qualify for the property tax exemption and the loss of the exemption applies as of the

beginning of the tax year.

(ii) The department shall notify each appropriate county treasurer that the property owned by an individual described in subsection (4)(c)(i) is subject to taxation and is not eligible for the state reimbursement under subsection (4)(b)(iii).

(iii) (5)(a) The property owned by a business organization with its principal headquarters located in Montana, including corporations but not including entities under subsection (4)(a)(iii) (5)(b), is exempt for each year that the owners are individuals and:

(A) (i) if there are less than 100 owners, all the owners pay or are liable for the payment of Montana income taxes; or

(B) (ii) if there are 100 or more owners, the owners of a majority of shares of stock pay or are liable for the payment of Montana income taxes; and.

(iii) property (b) Property within a trust, partnership, or similar legal entity is exempt for each year that all the trustees, partners, or similar members of the entity file Montana income tax returns.

(b) (6) Property leased to a person or entity that is not subject to income taxes is not exempt from property taxes under the provisions of subsection (4)(a) unless both the lessor and the lessee qualify pursuant to subsection (4).

(c) (7) The provisions of Article VIII, sections 3 and 4, apply only to property and property taxpayers subject to property taxes. Under this section, property taxes may not be increased beyond an inflation factor as provided by law.

(5) (8) Only individuals claiming legal residency in the state are subject to taxation of income."

Section 2. Article VIII, section 16, of The Constitution of the State of Montana is amended to read:

"Section 16. Limitation on Retail sales of goods subject to sales tax or use tax -- limitation on rates. (1) (a) Retail sales of goods and the use of goods purchased in another state are subject to a sales tax or use tax at a rate not to exceed that specified in this section:

(b) The wholesale of goods to be sold by a purchaser for resale and goods sold to be used directly as a component of finished manufactured goods are not retail sales:

(c) Corporate stocks, bonds, security, insurance premiums, wages, salaries, and similar financial documents or transactions are not goods and are not subject to any type of transaction tax:

(d) Sales to entities that may not be taxed under the constitution or laws of the United States are not subject to the sales tax or use tax:

(2) The legislature shall establish a rebate of sales tax or use tax paid in an annualized amount equal to not less than the amount of sales tax or use tax that would have been collected on purchases equal to not less than 15% of the per capita personal income for the state in the year preceding the income tax year for which the rebate is claimed. The rebate shall be administered through the income tax system. The rebate may consist of a refundable amount for eligible claimants who are legal residents of the state and who do not have taxable income or who have an income tax liability that is less than the allowable rebate.

(3) The rate of a general statewide sales tax or use tax may not exceed 4%."

NEW SECTION. Section 3. Effective date. If approved by the electorate, these amendments are this amendment is effective January 1, 2007.

NEW SECTION. Section 4. Submission to electorate. This amendment shall be submitted to the qualified electors of Montana at the general election to be held in November 2006 by printing on the ballot the full title of this act and the following:

- FOR revising taxation by limiting income taxes to residents, and exempting income taxpayers from property taxes, establishing a sales tax, and providing for certain rebates.
- AGAINST revising taxation by limiting income taxes to residents, and exempting income taxpayers from property taxes, establishing a sales tax, and providing for certain rebates.

House BILL NO. 779

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30

INTRODUCED BY

Edward R. Boudreau
(Primary Sponsor)

A BILL FOR AN ACT ENTITLED: "AN ACT SUBMITTING TO THE QUALIFIED ELECTORS OF MONTANA AN AMENDMENT TO ARTICLE VIII, SECTION 16, OF THE MONTANA CONSTITUTION ESTABLISHING A RETAIL SALES AND USE TAX WITH A BASE REFUNDABLE AMOUNT; AND PROVIDING AN EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

Section 1. Article VIII, section 16, of The Constitution of the State of Montana is amended to read:

"Section 16. ~~Limitation on~~ Retail sales of goods subject to sales tax or use tax -- limitation on rates. (1) (a) Retail sales of goods, the use of goods purchased in another state, and sales of real property are subject to a sales tax or use tax at a rate not to exceed that specified in this section.

(b) The wholesale of goods to be sold by a purchaser for resale and goods sold to be used directly as a component of finished manufactured goods are not retail sales.

(c) Corporate stocks, bonds, security, insurance premiums, wages, salaries, and similar financial documents or transactions are not goods and are not subject to any type of transaction tax.

(d) Sales to entities that may not be taxed under the constitution or laws of the United States are not subject to the sales tax or use tax.

(2) The legislature shall establish a rebate of sales tax or use tax paid in an annualized amount equal to not less than the amount of sales tax or use tax that would have been collected on purchases equal to not less than 15% of the per capita personal income for the state in the year preceding the income tax year for which the rebate is claimed. The rebate shall be administered through the income tax system. The rebate may consist of a refundable amount for eligible claimants who are legal residents of the state and who do not have taxable income or who have an income tax liability that is less than the allowable rebate.

(3) The rate of a general statewide sales tax or use tax may not exceed 4%."

NEW SECTION. Section 2. Effective date. If approved by the electorate, this amendment is effective January 1, 2007.



1

2 COORDINATION SECTION. **Section 3. Coordination instruction.** If House Bill No. 408 is not passed
3 and approved by the electorate, then this amendment is void.

4

5 NEW SECTION. **Section 4. Submission to electorate.** This amendment shall be submitted to the
6 qualified electors of Montana at the general election to be held in November 2006 by printing on the ballot the
7 full title of this act and the following:

8 FOR establishing a sales tax and providing for certain rebates.

9 AGAINST establishing a sales tax and providing for certain rebates.

10

- END -