EXHIBIT 2
DATE 4.3.07
SB 281

SB 281- Income Tax Simplification for Working Married Couples *(Sen. Joe Balyeat, CPA)*
This bill simplifies income tax filing for married couples filing separate MT returns. SB 281 says you get the same deductions you got on your federal return, even if you file as married filing separately.
I'll give you the short summary first, then explain the details:
Compared to current law, SB281 is 1) fairer, 2) simpler, 3) Costs the general fund almost nothing, and 4) is good politics as well as good policy. And because it's good politics as well as good policy, I'm very hopeful we'll get a unanimous vote coming out of this committee. Let me explain those 4 points:
1) It's fairer – We shouldn't be penalizing two wage-earner families for no logical reason. They should get the same deductions on the MT return that one wage-earner families get. **2) SB281 is simpler-** Current law disallows deductions that the Feds have already allowed. This current law thus requires that you, or your accountant, must keep two sets of records from year to year to year ad infinitem to keep track of your dual cost basis, which is now different for federal purposes than it is for state purposes. **3) SB281 costs virtually nothing long term**. Why? Because, as I just pointed out, any deductions that MT disallows you in the current year, get to be added on to your cost basis of that item for future years; and eventually, sometimes years down the road, you'll eventually get the tax break for that disallowed deduction anyway. 4) **SB281 isn't just good policy, its good politics**. Why? Because almost every dime of this temporary tax relief goes to low and middle income two-wage earner families. Virtually none of it goes to "rich" taxpayers because federal rules already phase out their deductions for these things -- rich people exceed the federal income limitations. Since this bill defaults to whatever federal deduction was allowed only low and middle income Montanans will benefit from it.

Now let me give a little more detail --

The bill says you get the same deductions you got on your federal return, even if you file as married filing separately. **Current tax law contains an unnecessary, unfair, and illogical piggyback on the federal requirement that you file jointly. This bill attempts to correct MT's unfair disallowance of IRA deductions, education deductions, rental losses, teacher expenses, and capital losses.**

I'll walk through an example illustrating what's wrong with the current law using rental losses, but the example illustrated also occurs with IRA deductions and these other deductions as well. Federal law permits you to deduct up to $25000 of rental losses if your joint income is below a certain level. But when married couples file separate federal returns, the feds disallow their entire rental loss because the feds can't easily track whether or not your combined marital income exceeds the cutoff level.

Yet even if a couple files their federal return jointly to qualify for the rental loss, they still lose that rental loss on their MT return if they file separately. The Dept of Revenue has argued in the past that this is necessary because of the federal joint return requirement. But the only reason the federal requirement is there is so that the feds can check your combined income to see if you exceed the cutoff income limit for rental losses. By the time you get around to doing your MT return, the allowable amount of your rental loss has already been established. So there's no logical reason to also enforce the joint filing requirement on your MT return.

Moreover, because MT law only has one rate schedule for married joint and married separate, MT law virtually forces all two-earner couples to file separate returns. Thus, they're unfairly punished just because of a quirk peculiar to the Montana income tax system. And here's the frosting on the cake:
Disallowed rental losses are added to your tax basis. Since the loss is only disallowed on the Montana return, and not the Federal return, tax-preparers end up having to keep two sets of books ad-infinitem from year to year. And when you finally sell the rental house, you have a different gain or loss on sale for federal purposes than you do for state purposes. More complications. This is a nightmare for taxpayers and it's an accountant's welfare plan.

If you pass this bill, it will greatly simplify the whole process. This bill says that regardless of whether you file jointly or separately on Montana, you get the exact same rental loss deduction as you got on your federal return. This is obviously simpler, and would eliminate the need to keep two sets of rental records.

This is also obviously fairer, because the feds have already made a fair determination of your allowable rental loss at the federal level based upon your joint income, and there is no justifiable reason to further reduce it at the state level. Now, I went through an explanation of the bill using only rental losses in order to simplify it for you. In addition to rental losses, this exact same problem also occurs in MT with respect to some IRA retirement deductions, capital loss deductions, tuition expenses, teacher expenses, and other passive losses. Unfair penalization of two-worker families, complicated tax returns, and duplicate tax records each year ad-nauseum. This bill fixes each of these issues the same way it fixes the rental loss problem. Whatever deduction you got on your federal return, you also get on your MT return regardless of filing status.

Moreover, because the feds have already disallowed these deductions completely for high income taxpayer, this fix to simplify MT taxes only benefits low and middle-income taxpayers with two wage-earners. This should definitely make this simplification and fairness bill be a nonpartisan issue.

I've had some amendments drafted to make sure it includes teacher expenses and education expenses, and also a set of amendments to simplify the Department's issuance of notices. If you pass these amendments the Dept would no longer have to send out separate notices for each spouse. Instead, the tax liability of the two spouses will simply be netted together, with only one penalty and interest calculation, and one balance due notice. This same netting process would occur for refunds, and only one 1099G would be issued for the combined refund.

The fiscal impact of this fix is relatively small about $500,000; and clearly justifiable given the fact that the current rule unfairly penalizes low and middle income two-wage earner families; and unnecessarily complicates MT's income tax system. But the longterm cost isn't even $500,000. **Long Term Fiscal Impact is $0.00.**

I'm not sure what the Dept of Revenue's position on this bill will be today. Hopefully, they'll support it. But in the past, Dept personnel argued that the current law disallowing these deductions is a trade-off for the benefits derived from filing separately. The evidence doesn't support that. The benefits from filing separately were established decades ago, in lieu of having a separate tax table with lower rates for joint filers. This was years before these federal deduction phase-outs even existed.

I believe I have some proponents including the Montana Society of CPAs here, so I'll sit and listen to that and also listen to any opposing arguments. I do believe opponent's arguments, if any, are largely addressed by amendments already, and I'm willing to make further amendments to address any additional concerns.

I'll sit and reserve the right to close.