EXHIBIT 1
DATE 4/12/11
SB 199

SB 199 – Sponsor's Testimony *(Sen. Joe Balyeat)*

SB 199 is my cleanup bill for the Department of Revenue. I believe there are several issues where DOR is overcharging or otherwise making it needlessly difficult for MT taxpayers.

I've known of some of these issues for several years in my CPA practice, and finally decided to do something about it in the 2007 session. My 2007 bill passed the Senate 50-0, was vetoed by the Governor. My 2009 bill again passed the Senate 50-0, and was stalled in House tax committee on a tie vote. When the press called me after the veto, I pointed out he had 5 factual errors in his veto letter… those errors revolved around his misunderstanding that the billed applied to late filing penalties, when it in fact only deals with late payment penalties. So I want everyone to be clear --- this bill has nothing to do with late filer penalties where people don't file or late file after their extended due date. This bill only applies to late payment penalties --- where someone has filed a proper extension, files their tax return on time, and yet still faces late pay penalties and interest sometimes at rates more than three times as high as the IRS charges under similar circumstances.

I had my revelation about the egregious level of these charges many years ago - I filed a proper extension on some tax returns in April; completed the returns before the October 15th extended due date, and sent the returns in together with the additional tax owing. I later received bills for interest and penalties; I did the calculations and determined that the total annualized charges amounted to roughly 33 to 34% per annum. I've spoken with numerous other CPA's who've seen similar exorbitant charges. Which is why the MT Society of CPA's will be here as a proponent today.

So here's what the bill does:

1) It reduces overly high MT late charges and conforms them with federal IRS rates for late payment.
2) It codifies the tax benefit rule as it relates to federal tax refunds, so that there is no more ambiguity --- Your federal tax refund is only subject to MT tax if it reduced MT taxes in the prior year. I recognize DOR has already backed away from earlier insistence on this issue, but I think it's preferable to have it right in statute rather than rule, so that no future DOR director could reverse that ruling again.
3) It eliminates an archaic rule allowing the DOR to charge the federal rate, or 8%, whichever is higher. I submit that if we have the technology to compute the federal rate for purposes of charging more than 8%, we can certainly also do that same computation for less than 8%; and everyone agrees it's preferable that we conform our rules as much as possible to follow federal law. I'll get back to this when I talk about the fiscal note.
4) It eliminates the DOR's ability to charge you a full month's interest when you're only one day or one week into the next month. And this is one issue which I've considered particularly egregious. Montana voters just passed an initiative to clamp down on payday loan companies, mandating them to charge a maximum interest of 36%. But I've done calculations to show that DOR's interest rate can run as high as 432% if you're only 1 day into the next month, because of the Neanderthal practice of charging you a full month's interest for any portion of a month.
5) It clarifies a safe harbor rule for estimated tax payments, that you're not subject to an estimated tax underpayment penalty if you made substantially equal payments satisfying the estimated tax requirements.
6) It also simplifies the process for penalty abatement when taxes are paid in full with the return. There are some instances where the DOR is penalizing people even when the taxes are paid in full. If the taxpayer writes back in 30 days begging forgiveness and paying the penalty, DOR then abates the penalty, sends a 3rd letter back to the taxpayer, and reissues a new check refunding the exact same amount back to the taxpayer. The amendment just says, if all that's owing is abatable penalty, let's just dispense with the three letters and two checks going back and forth, and just abate the penalty up front.

The MT Society of CPA's will testify in favor of this bill today.

I want to clarify one area of confusion. SB199 *has nothing to do with late filing penalties*. Montana's late filing penalties are substantial, and they're not modified one iota by SB199. SB199 only applies to late payment penalties which are assessed against Montanans even if they've filed extensions and file their return (with payment in full) by the extended due date. I want to make sure everybody is clear on that issue.

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A separate bill (SB411) dealing with fraud and people deliberately abusing the system. It has a contingent voidness hooking it to this bill; and it offsets the fiscal note.

MT's income tax system is one of voluntary compliance. I received a letter from a former IRS Treasury agent supporting SB199. I'd like to read a couple excerpts from that letter:

Unlike late filing penalties, "Late payment penalties and interest are assessed against honest Montanans who file their returns on or before the extended due date, and even pay all their tax due by that date. *Without passage of SB199, honest Montana taxpayers are being assessed late pay penalties as much as 3 times as high as the IRS charges.*

During my Treasury career, I found that some honest taxpayers get unfortunately caught up in single-year tax situations which cause them to "slide out" of our voluntary income tax reporting system. This often happens when they make every effort to comply with the law, yet then find themselves nonetheless assessed enormous penalties and interest charges which seem just completely unjust. At the federal level, in depth study has been devoted to developing a penalty and interest structure which provides sufficient incentive for taxpayers to pay their taxes on a timely basis, yet such penalty and interest charges aren't set so high so as to present a destructive barrier for taxpayers who wish to catch up on late tax payments.

SB199 addresses this important issue where Montana taxpayers are being overcharged. Even taxpayers who have filed proper extensions find themselves being charged exorbitant penalty and interest rates which can be as high as 30+% per annum. SB199 sets the DOR's interest and penalty provisions to exactly match the interest and penalty rates charged by the IRS. The fact that SB199 shows a fiscal note is only proof that Montana has been grossly over-charging its own citizens.

But from my substantial experience with federal income tax compliance, I ask you to consider this point. If you don't pass SB199, it's quite possible that you will actually cost the state treasury enormous sums of money far exceeding the fiscal note on this bill. In a tax system totally reliant upon voluntary compliance, provisions which are grossly and unfairly onerous, lead otherwise honest citizens to "slide out" of the system. As a former investigator of chronic non-filers, I can assure you that the cash flow lost from multi-year non-filers makes the annual cost of this bill miniscule in comparison. I urge legislators to set politics aside and vote for passage of this bill. SB514 passed [the Senate] unanimously, and SB199 has extensive bi-partisan co-sponsorship. It is heavily supported by the Montana Society of CPA's. Why? Because this bill has great merit with respect to tax-fairness. Moreover, as I've demonstrated, the cost of not passing this bill may even be higher than the cost of passing it."

With that, I'll distribute a written copy of my comments for the record, listen to proponents and opponents if any; answer questions, and reserve the right to close.

Closing -- When I first went into practice, the IRS was viewed as the bad guys, and DOR as taxpayer friendly. Unfortunately, over the years there's been a complete role reversal. Now the DOR is viewed as the bad guys, and I think it's potentially undermining our voluntary compliance system. I'd like to just read a few excerpts from a letter I received recently <read>

Why do we need this bill? First, fairness to our own taxpayers. Why do we need to charge Montana's hardworking citizens rates 3 times as high as what the IRS charges? Secondly, MT's income tax system is one of voluntary compliance. In such a voluntary compliance system, I think it's important that the collection agency have a good rapport with the taxpayers, and I think SB199 will go a long ways towards that end. Thank you for a good hearing.

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