

Revenue and Transportation Interim Committee
February 16, 2006
Prepared by the Department of Revenue

Top 5 Business Income Issues

I. Abusive Tax Shelters

A. Transactions used to hide or disguise income

B. Includes IRS identified "listed" and "reportable transactions", inconsistent filing positions in different states, and abusive transactions identified by states (e.g. captive real estate investment trusts (REITs) and regulated investment companies (RICs))

II. Corporate Tax Loopholes

A. Real estate investment trusts (REITs) violate the source principle of taxation

B. Insurance stuffing – profitable and taxable subsidiary is moved into insurance companies to avoid taxation

C. International transfer pricing problems

III. Trusts

A. Use of trusts to hide income

B. Montana statutes do not clearly specify which trusts must file Montana returns, how a trustee's residency status determines trust status, or how grantor trusts should be treated. Because nonbusiness trusts do not register with the Secretary of State and may have a federal tax address outside Montana, there is no way to monitor Montana compliance.

IV. Unreported income earned in Montana

A. Non-resident sales and exchanges of real property

B. Non-resident rents and royalties

C. Nexus Investigations - Out-of-state companies doing business in Montana without reporting income and paying taxes

D. Various underreporting issues

V. Pass-Thru Entities

A. Improper use of pass-thru entities to hide income

1. Back channel S corporation payments

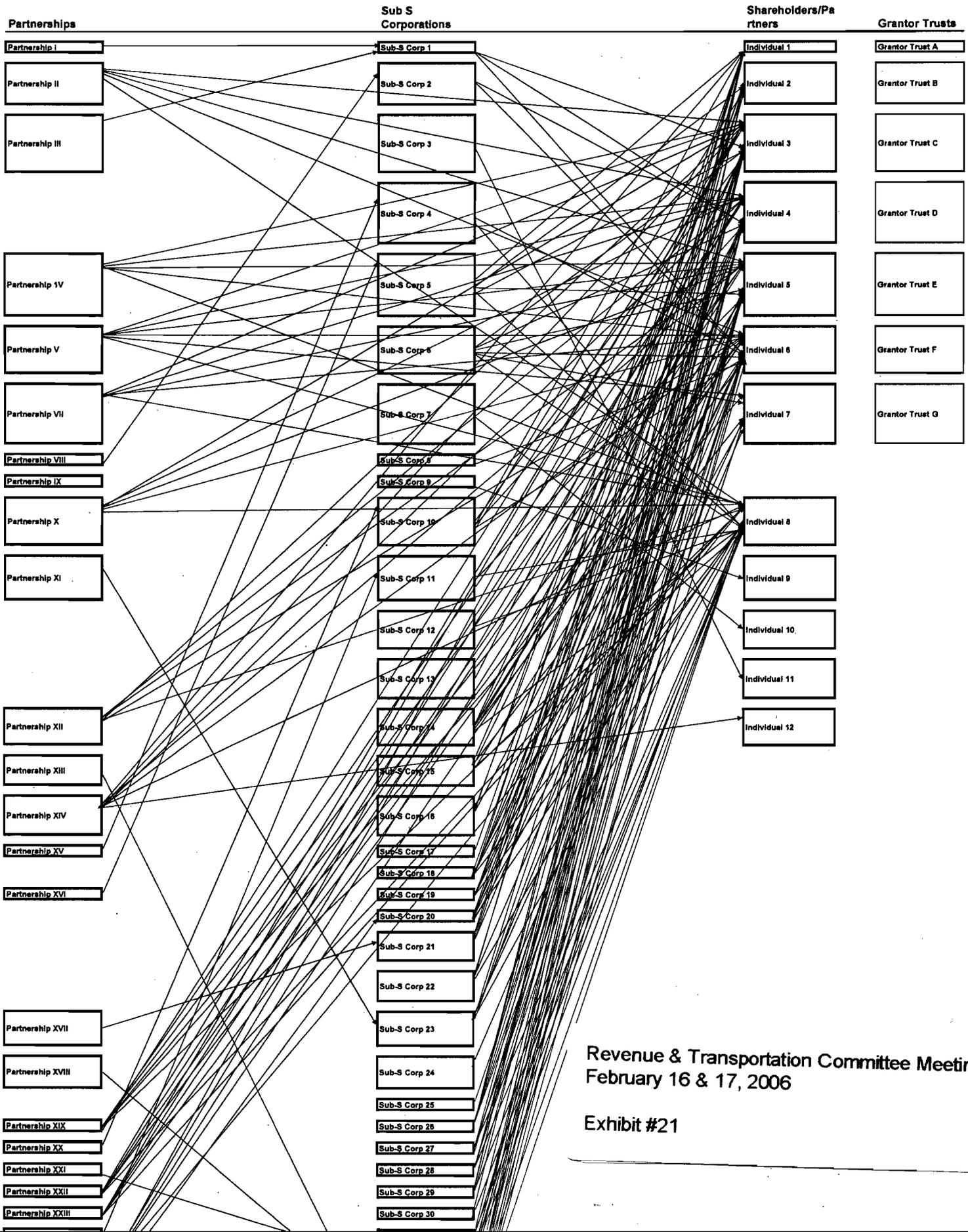
B. Non-conformity with changed federal tax provisions

1. Special treatment of S corporation subsidiaries and shareholders

2. Built-in gains provisions

Audit Complexity:

Sample ownership interests of a Corporation with Montana Source Income. Income and expenses would have to be tracked through all entities to ensure the correct calculation of Montana tax.



Revenue & Transportation Committee Meeting
February 16 & 17, 2006

Exhibit #21