MONTANA STATE AFL-CIO

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Testimony of Jim McGarvey, Executive Secretary
Montana State AFL-CIO, on the Source Income Rule
Revenue and Transportation Interim Committee Meeting
February 16, 2006

Mr. Chairman, members of the committee: My name is Jim McGarvey, Executive Secretary of the Montana AFL-CIO. I am here today to offer testimony on the Source Income Rule. I will highlight my main points and provide copies of my complete testimony.

The Montana Department of Revenue (DOR) is in the process of adopting rules formalizing its authority to tax capital gains -- that is, money earned from sales of real property. This process is important to working Montanans for one simple reason: All income earned in a state should be taxable in that state.

This essential principle is being ignored by a number of out-of-state residents who have not and will not pay taxes when they sell Montana property and reinvest the money in another state. The DOR recently announced that it was going to enforce payment of taxes, both current and delinquent, on 1031 exchanges, which govern taxation of certain real estate sales. Some non- residents claim that taxing them for the money they make selling Montana holdings will limit investment in the state.

It's probably worth asking how taxing money that is earned in Montana and then invested out of state will limit in-state investment. However, the real question is, "Why shouldn't out-of-staters who make money in Montana be subject to the same taxes paid by state businesses and working Montanans?"

Anyone who receives a W-2 tax form in Montana pays his or her fair share of taxes. Every Montana resident who owns property in the state pays taxes on that property. Any Montana business that sells property and remains in the state is taxed on the gains from the sale.

Montanans work hard, and they meet their financial obligations. They believe in paying their fair share on the money they earn. A recent Associated Press article reported that 97 percent of Montanans who make money from a capital gains transaction pay their taxes on time, while only 27 percent of non-residents make timely tax payments. The article also noted that 29 percent of the 96 biggest tax delinquencies were owed by non-residents and added up to about $1.1 million. The $1 million-plus does not include potential revenue from current and future taxation of 1031 transactions by non-residents.

By adopting a Source Income Rule -- which will formalize the already-legal procedure for capital gains taxation -- the state DOR will be protecting Montana businesses and Montana workers by ensuring that any person or entity making money in the state pays taxes on that income. The rule will actually remove the incentive to invest outside of Montana. In addi

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Exhibit #30

means that non-residents who live and/or make money in the state help pay for public services instead of reaping the benefits of taxes paid by Montana workers and businesses. Tax enforcement also discourages real estate speculation, which can drive the cost of property out of the range of the average Montana income.

In short, the Source Income Rule closes a tax loophole that gave huge tax advantages to wealthy out-of-staters at the expense of working Montanans.

Working Montanans, particularly union members, are the foundation of Montana's tax revenue. They do not have the option to pay or not pay taxes, or to benefit from unfair tax loopholes – nor do they want to benefit from any inequitable system. Union members pull their weight under the state's taxation system. They expect all others who benefit from Montana's unique environmental and economic opportunities to do the same.

Union members applaud the Montana Department of Revenue for working to apply fair taxation principles to all individuals who earn income in Montana, whether they are wage earners or out-of-state property owners.