Motor Vehicle Taxation and Other Issues Before the Revenue Oversight Committee Final Report

Revenue Oversight Committee

December 1996

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PREFACE

This document is the final report of the Revenue Oversight Committee for the 1995-96 interim. It is divided into two unrelated chapters. Chapter One is the final report from the study of motor vehicle taxation. The 1995 Legislature did not assign any formal studies to the Committee. However, the Committee decided that a review of the taxation of motor vehicles should be one of its policy priorities.

Chapter Two discusses a limited number of other issues that came before the Revenue Oversight Committee during the interim. These issues include the application of the beneficial use tax to ski areas, the allocation of the metal mines tax to the resource indemnity trust fund, the railroad car tax settlement and other tax settlement issues, and coal severance tax litigation related to the Crow Indian Tribe lawsuit.

RECOMMENDATIONS

The Revenue Oversight Committee recommends that the 55th Legislature enact the following legislation: [1]

LC 77

An Act generally revising the allocation of the metal mines license tax; correcting an overallocation of the metal mines license tax; providing that 15.5 percent of the metal mines tax is distributed in the same manner as the resource indemnity and ground water assessment tax.

LC 78

An Act clarifying the definition of the average statewide mill levy applied to railroad cars operating within the state.[2]

LC 101

An Act exempting recreational leases from the beneficial use property tax.

LC 218

An Act generally revising the classification and taxation of certain trailers, campers, and truck toppers; imposing a fee in lieu of ad valorem taxes on all trailers, pole trailers, and semitrailers having a declared weight of less than 26,000 pounds; exempting from taxation all campers and truck toppers.

LC 219

An Act generally revising the classification, valuation, and taxation of motor vehicles; taxing automobiles, trucks having a rated capacity of 1 ton or less, vans, and sport utility vehicles at 2 percent of the depreciated value of the manufacturer's suggested retail price; exempting from property taxation

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[1] Copies of the bill drafts may be obtained from the Legislative Services Division.

[2] At the December 2, 1996, meeting, the Committee adopted a proposal that would tax railroad cars at 95% of the commercial and industrial levy. Chapter 2 discusses issues related to the taxation of railroad cars, but this proposal was adopted after Chapter 2 was written.

buses, trucks having a rated capacity of more than 1 ton, truck tractors, and personal property attached to these exempt vehicles; imposing a fee in lieu of property taxes on buses, trucks having a manufacturer's rated capacity of more than 1 ton, and truck tractors; providing for the proration of the fee in lieu of tax for buses and trucks; replacing the tax on quadricycles with a fee in lieu of tax.

CHAPTER ONE
MOTOR VEHICLE TAX STUDY

INTRODUCTION

During the 1995 Legislative Session, the Montana Legislature considered House Bill No. 363, a measure that would have revised the taxation of motor vehicles. The bill was the result of the efforts of an advisory committee appointed to look at ways of simplifying motor vehicle taxes. Although the bill passed the House of Representatives, it was tabled in the Senate Taxation Committee. The members of the Senate Taxation Committee concluded that the issue of motor vehicle taxation required additional study and more taxpayer involvement in the development of a proposal. During executive action on the bill, Senator Mike Foster suggested that the issue should be addressed by the Revenue Oversight Committee (Committee). At its November 17, 1995, meeting, the Committee decided that motor vehicle taxation should be one of its policy priorities.

Committee staff asked several representatives of government agencies and motor vehicle associations to assist the Committee in its consideration of motor vehicle taxation. This motor vehicle taxation advisory group provided technical assistance and insight in the formulation of proposals, based in large measure on the provisions of House Bill No. 363, to revise the taxation of motor vehicles and trailers. The Committee has recommended that two proposals be adopted by the 55th Legislature.

This chapter reviews the genesis of House Bill No. 363, the activities of the motor vehicle taxation advisory group, and the proposals recommended by

the Committee.

HOUSE BILL NO. 363

Development of the Legislation

During the November 1993 Special Session, the Montana Legislature enacted House Bill No. 50 (Ch. 27, Sp. L. November 1993) to generally restructure the property valuation and assessment functions of the Department of Revenue (Department). The bill also directed the Governor to appoint an advisory committee to study the valuation and taxation of motor vehicles and mobile homes. The membership of the committee had to include a County Treasurer,
a County Assessor, an employee of the Motor Vehicle Division (Department of

Justice), an employee of the Department of Transportation, and an employee of the Property Assessment Division (Department of Revenue). The committee was instructed to "study the methods and processes for the valuation and taxation of motor vehicles and mobile homes".[3]

Under current law,[4] several state agencies are involved in the assessment and collection of taxes and fees on motor vehicles and trailers. Cars and light trucks with a rated capacity of 1 ton or less are subject to a tax equal to 2% of the average trade-in value listed in National Automobile Dealers Association used car guides. These values are generated automatically from computer tapes by the Motor Vehicle Division, Department of Justice. If, however, information is not available for a particular vehicle, its value is

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[3] The advisory committee was unable to adequately address the complexities of the valuation and taxation of mobile homes.

[4] The discussion of current law relies in part on Motor Vehicle Advisory Committee Findings (Draft).

determined by the Department of Revenue. Quadricycles (and, formerly, motorcycles)[5] are also valued by the Department of Revenue.

Buses, trucks having a rated capacity of more than 1 ton (heavy trucks), and trailers having declared weight of less than 26,000 pounds are taxed as class eight property under 15-6-138, MCA. These vehicles are valued by the Department of Revenue, and the values are based on average wholesale values contained in national appraisal guides or manuals.

Interstate fleets, including cars and light trucks as well as heavy trucks, are valued by the Department of Transportation. The market value of a heavy truck in an interstate fleet is based on the purchase price of each taxable vehicle in the fleets, depreciated by a schedule prepared by the Department of Revenue. Market value is determined by multiplying the depreciated value of the vehicle by the percentage of miles traveled in Montana. Interstate fleets are taxed at the applicable class eight property tax rate. The total tax on an interstate fleet

is equal to the taxable value of the fleet times the statewide average mill levy.[6]

The involvement of several state agencies in the taxation of motor vehicles and trailers and the different methods of valuation led the advisory committee to try to simplify the process. The goals of the advisory committee were to improve customer satisfaction, to increase efficiency by revising and simplifying the current method of taxation, and to maintain revenue neutrality. The result of the advisory committee's work was the

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[5] Motorcycles were previously subject to the 2% tax and valued by the Department of Revenue. Senate Bill No. 161 (Ch. 580, L. 1995) replaced the tax on motorcycles with a fee based on the motorcycles' age and engine size.

[6] An additional 45 mills are levied against all trucks and truck tractors of 26,000 pounds or more gross vehicle weight to account for the property tax exemption for trailers that have a licensed gross weight of 26,000 pounds or more (see 15-24-2501, MCA).

introduction in 1995 by Representative Emily Swanson of House Bill No. 363. The bill, requested by the Department of Revenue, would have:

- taxed all motor vehicles at 2% of the depreciated value of the manufacturer's suggested retail price (MSRP);[7]
- imposed the new car sales tax on all new motor vehicles based on the MSRP;
- exempted from taxation all campers and truck toppers; and
- imposed a fee in lieu of tax on all trailers and semitrailers.

Legislative Action

House Bill No. 363 was heard in the House Taxation Committee on February 10, 1995.[1] Opponents testified that the bill would adversely affect the trucking industry because the MSRP was generally much higher than the typical selling price of heavy trucks in Montana. They suggested that acquisition price would be a better basis for determining value for large trucks. In addition, the same opponents were concerned that they would be worse off under the proposed legislation if class eight property (business equipment) tax rates were reduced.[8] Other opponents argued that the current system works well and that the anticipated tax and revenue shifts do not justify changing the system.

The House Taxation Committee amended House Bill No. 363 to use acquisition price as the basis for determining value for large trucks and revised the proposed depreciation schedule applied to all vehicles.

Following passage by the House, the bill was heard in the Senate Taxation Committee on April 5, 1995.[2] Most of the previous opponents supported the bill, provided that amendments prepared by the Department were adopted. The amendments would have eliminated large trucks from the revised system until December 31, 1997. After that, large trucks would be

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7 The manufacturer's suggested retail price is based upon standard equipment on a vehicle and does not include price additions or deductions for optional accessories.

8 Senate Bill No. 417 (Ch. 570, L. 1995) provides for the phased-in reduction of the class eight property tax rate from 9% to 6%.

valued based on acquisition price and would be subject to a separate depreciation schedule. In addition, the sales tax applied to heavy trucks would be calculated based on acquisition price. Despite the newfound support for the bill, Senate Taxation Committee members questioned whether the trucking industry and others had been adequately involved in the development of the proposal. That Committee also questioned the amendments adopted by the House. In particular, the Senate Taxation Committee was concerned about the shift in tax burden for cars and light trucks based on vehicle type and age. Because of the apparent problems in the bill, Senator Foster moved that the bill be tabled. He also suggested that the Revenue Oversight Committee study the issue of motor vehicle taxation during the 1995-96 interim. At its November 17, 1995, meeting, the Committee decided that motor vehicle taxation should be one of its policy priorities.

STUDY OBJECTIVES FOR REVISING THE TAXATION OF MOTOR VEHICLES

In early January 1996, Committee staff asked several representatives of government agencies and motor vehicle associations to assist the Committee in its consideration of motor vehicle taxation. This "motor vehicle taxation group" included employees of the Departments of Justice, Revenue, and Transportation, a County Treasurer as well as a representative from the Montana Automobile Dealers Association, and representatives of the trucking industry. The group was informally divided into a project team and an advisory group. A list of all members is attached as Appendix A. The project team was involved in data collection and analysis and, in conjunction with the advisory group, the development of policy options for presentation to the Committee.

Policy Questions

The entire motor vehicle taxation group met January 10, 1996, to begin the discussion of issues related to the taxation of motor vehicles. Participants generally agreed that House Bill No. 363 would be a good starting point for further analysis. However, in order to evaluate the alternatives that may be appropriate for changing the way in which motor vehicles are taxed, the

study plan presented to the Committee at its February 2, 1996, meeting[3] recommended that several questions be considered:

1. Is the current system for the taxation of motor vehicles so complex and inefficient that it should be significantly revised?

2. Is the method of taxing automobiles and light trucks more complex than the method of taxing large trucks, or vice versa?

3. What are the disparities in the taxation of motor vehicles and trailers (including the disparities between interstate and intrastate vehicles and trailers)? Are these disparities justifiable?

4. Can improvements be made to the current system to minimize inequities and administrative and compliance costs?

5. If House Bill No. 363 is the best alternative, what is the appropriate method of valuing different types of motor vehicles and what is the appropriate depreciation factor?

6. Are there better alternatives?

7. If the current system is revised, what is the (new cliche) "shift and shaft factor"? That is, who are the (old cliche) winners and losers, both in terms of the taxpayer and state and local governments?

8. What desirable features of a new or improved system would be necessary to offset the undesirable effects of the shift and shaft factor?

MOTOR VEHICLE TAXATION STUDY

The project team and the advisory group met several times between January 1996 and September 1996. Most of the policy issues and data analysis as well as the development of the final proposal were undertaken by the

project team. The work of the project team was presented to both the advisory group and the Committee.

The project team considered several options regarding the taxation of passenger vehicles and heavy trucks. The options included flat fees, variations of House Bill No. 363, and the existing system. The project team (and the advisory group) decided early on that the existing system should be revised and that some variation of House Bill No. 363 would improve the system. The primary goals of the project team were to minimize the tax impact on taxpayers and the revenue impact to local governments. The following two sections describe the development of the separate proposals related to revising the taxation of passenger vehicles and heavy trucks. The project team and the advisory group also decided early on that the taxation of trailers should be revised as provided in House Bill No. 363. The final section discusses Committee action on the proposals.

Passenger Vehicles

Passenger vehicles include automobiles, light trucks, vans, and sport utility vehicles. All new motor vehicles are subject to a 1.5% sales tax. Passenger vehicles (except new vehicles subject to the 1.5% sales tax) are taxed, for local property tax purposes, at 2% of the average trade-in value obtained from the National Automobile Dealers Association used car guides ("Blue Book").[9] A county may impose a local option tax on passenger vehicles up to 0.5% of the value of the vehicle (61-3-537, MCA). The motor vehicle property tax is first imposed in the year following the purchase of the new vehicle. As a result, there is generally an increase in the tax paid, or a "spike", on the vehicle in the next year. There may be an additional spike in the following year for certain vehicles. In the first year that the property tax is imposed, motor vehicles are valued, because Blue Book values are not available, at 80% of the vehicle's MSRP. Consequently, the Blue Book value of the vehicle in the subsequent year may be higher than the calculated

[9] Passenger vehicles are not subject to local mill levies. Revenue from the motor vehicle tax is distributed in the relative proportions required by the levies for state, county, school district, and municipal purposes in the same manner as personal property taxes are distributed (61-3-509, MCA).

value.[10] Finally, Blue Book values may increase or remain constant from one year to the next. Thus, there may again be a tax increase even though the taxpayer has come to expect a tax decrease.

One of the principal objectives of the project group was to eliminate the apparent vagaries in the taxation of passenger vehicles by developing a simplified tax structure that is predictable and that is easy to understand and to administer. The project group considered several options, including a flat fee. In 1981, the Montana Legislature replaced the property tax on passenger vehicles with a flat fee schedule based on the age and weight of the vehicle (Ch. 614, L. 1981). Previously, automobiles and light trucks were taxed at 13% of market value and were subject to local and statewide mill levies. The legislation provided for state reimbursement for lost revenue to local taxing
jurisdictions. In 1987, the Legislature eliminated the flat fee and imposed the current 2% tax (Ch. 611, L. 1987). The project group concluded that the flat fee approach was inequitable and, based on an analysis of the data, would result in large revenue gains or losses among local governments.

The project team developed various options to revise the taxation of passenger vehicles based on the House Bill No. 363 model. At the Committee's June 24 meeting, Jeff Martin, Committee staff, presented a report that described several options for revising the taxation of passenger vehicles.[4] Each option would tax passenger vehicles at 2% of the depreciated value of the MSRP. Data for the report was complied from Department of Justice data tapes by Larry Finch, Program Manager, Office of Research and Information, Department of Revenue. The report included information on the shift in tax burden for passenger cars, light pickups, vans, and "sports utility" vehicles as well as the revenue impacts to state and local governments.

The guiding assumption (owing, perhaps, to a long postsession hangover)

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10 Refer to Appendix B, An Alternative Approach to Taxation of Light Cars and Trucks in Montana, pp. 7 and 8, for additional discussion of "spiking" issues.

for the analysis was that revenue neutrality should be maintained with respect to total taxes. Under each option, the new car sales tax revenue would fall by about $558,000 (assuming that the sales tax were uniformly imposed based on the MSRP. See below.), while the locally imposed motor vehicle tax would increase revenue by a like amount statewide. Blue Book values for cars tend to decline faster than for other types of passenger vehicles, particularly pickups and sport utility vehicles. By applying the same arbitrary depreciation schedule to each type of vehicle, the tax burden for cars increases, while the tax burden decreases or remains the same for other types of vehicles. The maximum increase for passenger vehicles would occur under Option 1 and would amount to a $5.7 million increase statewide.[5] The shift in tax burden to cars would be mitigated under an option (Option 3) that would use a separate depreciation schedule for pickups. However, the increase in passenger car taxes statewide would amount to $2.9 million.[6]

The analysis showed the combined impact to the state from lower sales tax collections and increased revenue from statewide mill levies (University System mill levy and school equalization levies) and the impact to local governments under each option. Depending on the option, the total revenue loss to the state would range from $400,000 to $435,000, while the revenue gain to local governments would range from $230,000 to $244,000. Revenue gains or losses to local governments would depend on the distribution by vehicle type and age within the taxing jurisdiction.

The Committee expressed concern about the shift in tax burden to passenger cars. Senator Foster articulated the Committee's concern: He did not remember direction from any Committee member that when the analysis on motor vehicle taxation was completed, the result was to "stick it to the passenger cars".[7] Mr. Martin told the Committee that the shift was due primarily to the assumption relating to revenue neutrality with respect to total taxes, including the new car sales tax. Because the new car sales tax and the motor vehicle tax are separate taxes, a better approach would be to devise an option that is revenue neutral with respect to local taxes, without regard to the new car sales tax.

The project group met July 18, 1996,[11] to consider an option that would alleviate the concerns of the Committee by having separate depreciation schedules based on type of vehicle (i.e., car, light truck, van, or sport utility vehicle) and age. The analysis of this option was prepared by Larry Finch and is attached as Appendix B. The depreciation schedules were determined by using the ratio of the total market value for each vehicle type to the total MSRP by vehicle type for each year of data available in the Department of Justice data base. The last attachment in Appendix B compares the tax liability for selected vehicles under current law with the proposed change. This approach better reflects current market depreciation schedules, eliminates the arbitrary depreciation schedules contained in the previously considered options, eliminates the "second-year spike", minimizes tax shifting by type and age of vehicle, and minimizes revenue gains and losses to local governments. Again, revenue gains or losses to local governments would depend on the distribution by vehicle type and age within the taxing jurisdiction.

The project team (and Senator Stang and Representative Tropila) agreed that this option be presented to the Committee. The project team decided not to
recommend changes to the new motor vehicle tax. Under current law (61-3-502, MCA), the sales tax is assessed against f.o.b. factory list price of a vehicle that is the same as the MSRP.

Committee staff presented the proposal to the Committee at its August 26, 1996, meeting. Steve Turkiewicz, Executive Director, Montana Automobile Dealers Association, praised the efforts of the project team, especially for streamlining the process. However, he refrained from giving the proposal an unqualified endorsement. He said that any revision in the taxation of motor vehicles is in the political arena. He said that although his Association does not oppose the proposal, it prefers the flat fee method.[8] Mary Whittinghill, Administrator, Property Assessment Division, Department of Revenue, said

11 Senator "Spook" Stang and Representative Joe Tropila participated in this meeting.

that under current law, the value of a vehicle has to be entered into the Department of Justice computer system each year. If the value of the vehicle is not known, it must be assessed by the Department of Revenue. Under the proposal, the MSRP would only have to be entered one time and the value would be calculated from the depreciation schedule.[9]

Dennis Burr, President, Montana Taxpayers Association, said that the revised depreciation schedules contained in the proposal are an improvement over the previous options considered by the Committee. He said that Blue Book values are better indicators of market conditions and that taxpayers would probably prefer to be taxed under the existing system rather than on the basis of some arbitrary depreciation schedule. He said, however, that the depreciation schedules would be fixed in law and would not reflect changes in market conditions that are captured by the Blue Book. He noted that under the proposal, vehicles that tend to hold their value would receive a tax decrease, while vehicles that do not would experience a tax increase.[10]

The Committee delayed action on the proposal to revise the taxation of passenger vehicles until the project team presented a proposal for heavy trucks.

Heavy Trucks

The term "heavy trucks" refers to buses, trucks having a rated capacity of more than 1 ton, and truck tractors. Heavy trucks are subject to the 1.5% sales tax. Heavy trucks are taxed, for local property tax purposes, as class eight property under 15-6-138, MCA, and are subject to local mill levies in the county of registration as well as to statewide levies. These vehicles are valued by the Department, and the values are based on average wholesale values contained in national appraisal guides or manuals.

The tax imposed on interstate fleets is administered by the Department of Transportation. Interstate fleets, except cars and light trucks, are taxed at the applicable class eight property tax rate. The total tax on an interstate fleet is equal to the taxable value of the fleet times the statewide average

mill levy. (See page 2 for the determination of market value for interstate fleets). Cars and light trucks in an interstate fleet are taxed at 2% of the Blue Book value. The tax is prorated based on the proportional miles traveled in state.

The final proposal for heavy trucks took a different tack from the proposal for passenger vehicles. Using the MSRP as the basis for taxing heavy trucks was dismissed on the grounds that the MSRP was a generally inflated price and that that price rarely reflected, even approximately, what a heavy truck would sell for in Montana. The entire motor vehicle taxation group agreed that acquisition price depreciated by a statutorily determined schedule would be an appropriate method for taxing heavy trucks.

The project team spent a lot of time discussing this method. The primary objective of the project team was to devise a method by which intrastate vehicles and interstate fleets would be taxed on the same basis. The team was concerned whether acquisition price would achieve that objective. One concern was the potential difference in sales price for identical vehicles. For example, a trucking firm that purchased several vehicles at a time may pay less for each vehicle than an individual operator who purchased only one vehicle. Another concern was whether the acquisition price would be uniformly available. A data base used by the Department of Transportation has information on acquisition price of heavy trucks, but similar data is not available for class eight trucks. The taxpayer, then, would be required to report, if the taxpayer knew it, the acquisition price of the vehicle. Such a situation would, as project team member Dan Wirak, Mergenthaler's Transfer and Storage Co., put it, "make liars out of taxpayers".

At the July 18 meeting, the project team (absent the trucking industry representative), began to rehash the acquisition price approach for heavy trucks, when someone asked, "What would be the matter with going to a flat fee?" The project team had discussed the flat fee approach earlier in the study

but had not pursued it. Given the impasse with acquisition price, the project team decided to look more closely at a flat fee schedule. The team asked Larry Finch to develop a revenue-neutral flat fee schedule for all heavy trucks based on age and weight of the vehicle.[12] To prevent large shifts in tax liability between age groups or weight classes, the fee schedule should reflect current law average tax liability within each age group and weight class. The initial analysis was based on eight age groups and four weight classes.

The proposal was sent to the motor vehicle taxation advisory group. Some members of the group expressed skepticism about the flat fee proposal. One problem that was noted was a slight shift in tax burden to interstate fleets. Another problem was using gross vehicle weight rather than some industry weight standard. Gross vehicle weight, or the loaded weight declared by the owner of the vehicle, may be different for identical trucks. Finally, the limited number of age groups may cause unacceptable tax shifting. The motor vehicle taxation advisory group met August 20, 1996, to address these issues. The group decided to develop a fleet fee schedule based on 16 age groups. The number of weight groups would remain the same, but the manufacturer's rated capacity would be used rather than gross vehicle weight. Finally, the group decided that the proposal should be revenue neutral for class eight trucks and for interstate fleets. The group directed Mr. Finch to "recrunch" the data to meet the objectives of the group.

Dave Galt, Administrator, Motor Carrier Services Division, Department of Transportation, informed the group that the separate taxation of personal property on interstate fleets would not be enforced by out-of-state jurisdictions under international proportional registration agreements. To maintain consistency in the "tax" treatment of class eight trucks and interstate fleets, the group decided that personal property attached to a vehicle should be exempt from taxation and that the fee schedule should

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[12] In tax year 1995, class eight trucks generated about $3.4 million in property tax revenue, while interstate fleets generated about $1.2 million.

capture the value of the personal property.

COMMITTEE ACTION

Bill Draft Requests

Mr. Finch presented the revised analysis of the flat fee proposal to the Committee on September 19, 1996. The report is attached as Appendix C. Mr. Finch said that the flat fee schedule is based on tax year 1995 data. Consequently, the flat fee schedule should be reduced by one-third to correspond with the reduction in the class eight property tax rate to 6% in 1998. The adjusted fee schedule is shown as Attachment 9 in Appendix C.

The flat fee proposal was supported by the Departments of Justice, Revenue, and Transportation and by Myron Mackey, Montana Tow Truck Association, Ben Havdahl (by letter), Montana Motor Carriers Association, and Mr. Wirak, Mergenthaler's Transfer and Storage Co. Committee staff informed the Committee that the proposal would exempt from taxation personal property attached to the vehicle. Ms. Whittinghill said that under current law, personal property attached to a vehicle is subject to tax. However, the tax would be paid only if the personal property is reported by the taxpayer. Under the proposal, personal property would be subject to taxation if it is detached from the vehicle.

The Committee requested that separate draft legislation be prepared for revising the taxation of passenger vehicles, heavy trucks, and trailers.

Committee Approval of Bill Drafts

At the Committee's October 18, 1996, meeting, Committee staff presented three bill drafts that would revise the taxation of passenger vehicles, heavy trucks, and trailers having a declared weight of less than 26,000 pounds. The Committee voted to introduce legislation to effect the changes. Committee staff recommended that the separate drafts to revise the taxation of passenger vehicles and heavy trucks be combined. Staff also

recommended that a fee in lieu of tax be imposed on quadricyles to coincide with the fee in lieu of tax on motorcycles.[13] The Committee concurred in both recommendations.

The combined bill drafts are contained in LC 0219. The essential elements of the draft include:

- the taxation of light vehicles (passenger vehicles) at 2% of the depreciated value of the MSRP;
- separate depreciation schedules for automobiles, light trucks, vans, and sport utility vehicles;
- a $500 floor on the value of a light vehicle;
- a fee in lieu of tax on quadricycles in the same manner as on motorcycles under 61-3-527, MCA;
- a fee in lieu of tax on heavy trucks based on age and the manufacturer's rated weight of the vehicle;
- the exemption from taxation of personal property attached to a vehicle;
- the proration (but not refund), based on the number of months remaining in the year, of the fee in lieu of tax on heavy trucks registered for the first time;
- the repeal of the special property tax provisions on motor vehicle fleets under Title 15, chapter 24, part 1, MCA, and the recodification under Title 61, chapter 3, part 7, MCA;
- the repeal of the tax levy on trucks and truck tractors under 15-24-2501, MCA; and
- the transfer of the Department of Revenue's motor vehicle assessment functions to the Department of Justice.

The revisions to the taxation of trailers is contained in LC 0218. The

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[13] A member of the project team asked Senator Stang, sponsor of Senate Bill No. 161 (see page 2), the measure that imposed the fee on motorcycles, to endorse the change for quadricycles.

proposed legislation would impose a fee in lieu of property taxes on trailers, pole trailers, and semitrailers, having a declared weight of less than 26,000 pounds. The fee would be based on the age and weight of the trailer. The legislation would also exempt all campers and truck toppers from taxation.

If the proposals are adopted by the 55th Legislature, they would be effective January 1, 1998. Copies of LC 0218 and LC 0219 may be obtained from the Legislative Services Division.

ENDNOTES

1. House Taxation Committee, Minutes, February 10, 1995, pp. 3-6.

2. Senate Taxation Committee, Minutes, April 5, 1995, pp. 3-6.

3. Jeff Martin, Proposed Study Plan: A Study of Motor Vehicle Taxation (Helena: Legislative Services Division, February 1996), pp. 1-7, in Minutes, Revenue Oversight Committee, February 2, 1996, EXHIBIT #2.

4. Jeff Martin, House Bill No. 363 Options for Revising the Taxation of Passenger Vehicles (Helena: Legislative Services Division, June 1996), pp. 1-10 and attachments, in Minutes, Revenue Oversight Committee, June 24, 1996, EXHIBIT #1.

5. Ibid., Attachment, Option 1.

6. Ibid., Attachment, Option 3.

7. Minutes, Revenue Oversight Committee meeting, June 24, 1996, p. 5.

8. Minutes, Revenue Oversight Committee meeting, August 26, 1996, p. 8.

9. Ibid., p. 9.

10. Ibid., pp. 9 and 10.

CHAPTER TWO

INTRODUCTION

During the 1995-96 interim, the Revenue Oversight Committee (Committee) considered several issues in addition to conducting the study on motor vehicle taxation. This chapter provides a brief summary of some of those issues and Committee action, if any.

APPLICATION OF BENEFICIAL USE PROPERTY TAX TO SKI AREAS

Introduction

At its November 17, 1995, meeting, Senator Mike Foster requested that the Committee review the applicability of the beneficial use tax to ski areas located on public lands.

Mick Robinson, Director, Department of Revenue, told the Committee that the Department of Revenue (Department) had met with the Montana Ski Areas Association to discuss whether ski areas on public lands are subject to the beneficial use tax. In a letter to a ski area operator, a private attorney concluded that "a strong argument can be made that a use of public lands by a ski area operator must be exclusive before the "beneficial use" tax may be legally imposed on that use".[1] A memorandum opinion prepared by the Department in response to that letter took the opposite view and maintained that "A person may be subject to taxation under the beneficial use tax for his use of public property for industrial, trade, or other business purposes even when that person does not have the "exclusive use" of the property."[2]

This section provides a brief history of the beneficial use tax in Montana and summarizes similar taxes in other states as they apply to ski areas. A separate memorandum prepared by the Committee's staff attorney discusses relevant case law related to the beneficial use tax.[3]

History of the Beneficial Use Tax in Montana

A beneficial use tax is a tax imposed on a taxable entity for the profit, benefit, or advantage derived from the use of property that is otherwise exempt from property taxation. This particular type of tax may come under many names and many guises, but for the purposes of this analysis, it will be referred to as the beneficial use tax.

The provisions of Montana's beneficial use tax are found under Title 15, chapter 24, part 12, MCA. The tax (or privilege tax on industrial, trade, or other business use of tax-exempt property) was enacted during the 1969 Legislative Session (Ch. 370, L. 1969). Representative Larry Fasbender, the sponsor of the legislation, testified that the bill was designed to tax businesses working under contract with a governmental agency. A Cascade County Commissioner cited the example of the Boeing Corporation renting trailers from the federal government for its employees. Local governments would be unable to tax these mobile homes without the enactment of a beneficial use tax.[4] The bill enacted 15-24-1203 (imposition of privilege tax), 15-24-1204 (rate of tax), 15-24-1205 (assessment and collection of tax), and 15-24-1206, MCA (county suit for delinquencies). At the time that the measure was enacted, the only exception to the tax was for:

> . . . the possession or other beneficial use of public lands occupied under the terms of mineral, timber or grazing leases or permits issued by the United States or the state of Montana or upon any easement unless the lease, permit or easement entitles the lessee or permittee to exclusive possession of the premises to which the lease, permit or easement relates.

There was no recorded testimony before either the House Ways and Means Committee or the Senate Taxation Committee regarding the rationale for the exception. The House Ways and Means Committee did adopt an amendment to add timber leases or permits as an exception.

Several other exemptions to the beneficial use tax have been added since the original enactment:

! buildings owned by public entities and located on public

airports (Ch. 387, L. 1977);

! transmission lines and facilities with a capacity of less than 500 kv (Ch. 683, L. 1983);

! railroad right-of-way or track owned by the United States (Ch. 621, L. 1991) or acquired by the state (Ch. 591, L. 1987); and

! property held by a port authority created by a county or municipality or a port authority owned by the United States as long as the user does not have exclusive use (Ch. 427, L. 1993).

In 1981, the Montana Legislature attempted to directly tax Bonneville Power Administration (BPA) transmission lines constructed for use by the Colstrip power companies. House Bill No. 36 (Ch. 478, L. 1981) provided for the

taxation as utility property of certain electric transmission lines owned and operated by a public agency (i.e., BPA). However, the act would not be effective unless the U.S. Congress passed legislation allowing the state to tax a public agency.

Rather than waiting for the U.S. Congress to act, the Montana Legislature in 1983 enacted legislation (Ch. 683, L. 1983) clarifying that the Colstrip power companies were subject to the beneficial use tax for the transmission of electricity along the BPA 500 kv transmission lines from Townsend west to the Taft substation on the Montana-Idaho border. The power companies challenged the tax on the grounds that the power companies lacked sufficient beneficial use of the transmission lines, as well as on a number of federal and state constitutional grounds. The Montana Supreme Court upheld the tax in separate cases.[5]

The Legislature has also made other changes to beneficial use tax provisions. In 1993, Senator Tom Beck sponsored Senate Bill No. 325 (by request of the Department) to clarify the interest that is subject to the beneficial use tax. The bill amended 15-24-1204, MCA, as follows:

> **15-24-1204. Rate of privilege -- tax credit for federal payments in lieu of taxes.** The tax imposed upon ~~such~~ <u>the</u> possession or other beneficial use of tax-exempt property [for

> industrial, trade, or other business purposes][14] ~~shall be in the same amount and to the same extent as the ad valorem property tax would be if the possessor or user were the owner thereof, provided that there shall be~~ is on the separate private interest in the tax-exempt property. The amount of payments that are made in lieu of taxes must be credited against the amount of tax that is imposed upon the beneficial use of property owned by the federal government.

Senator Beck told the Senate Taxation Committee that Senate Bill No. 325 (Ch. 256, L. 1993) was in response to the Montana Supreme Court decisions that upheld the beneficial use tax on the Colstrip power companies.[6] During executive action, Dave Woodgerd, Chief Legal Counsel, Department of Revenue, informed the Senate Taxation Committee that the bill would conform the beneficial use tax to the Supreme Court's interpretation.[7] The change ensures that separate private uses of the same tax-exempt property are subject to the tax.

Also in 1993, Senator Steve Doherty introduced Senate Bill No. 183 (Ch. 90, L. 1993) to provide that property owned by both a tax-exempt and taxable entity or used for both tax-exempt and taxable purposes be assessed and taxed based upon the apportioned ownership or use of the property.

There are few exemptions from the beneficial use tax, and those exemptions apply to specific types of property. In addition, exclusive use is required only for mineral, timber, and grazing leases or for certain port authorities before the tax may be applied. Finally, recent legislative action has clarified the scope of the tax by apportioning the tax to separate users of tax-exempt property.

Beneficial Use Tax on Ski Areas in Other States

Close to one-half of the states tax the possessory interest on federal and

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14 The phrase in brackets was added by House Bill No. 312 (Ch. 104, L. 1993) to clarify that the beneficial use tax applies only to commercial activity and not, for example, to the rental of living accommodations.

state property.[8] In December 1995, Committee staff conducted a telephone survey of the Departments of Revenue in five states (Colorado, Idaho, Utah, Washington, and Wyoming) to find out whether they tax the beneficial use of ski areas located on federal land. Staff also reviewed the applicable statutes. The following is a summary of that survey and review.

Colorado

Section 39-3-135, Colo. Rev. Stat., imposes a tax on the use of real property that is exempt from taxation. The use must be in connection with a business conducted for profit. In general, the assessment, computation, and collection of the tax are identical to those of the ad valorem property tax. There are specific provisions in section 39-3-135, CRS, for determining the value of the possessory interest of a ski area located on federal land. The value is calculated by capitalizing the annual fee paid by the ski area to the United States.

Idaho

Idaho law is brief and to the point: Section 63-105G, Idaho Code, exempts from taxation the possessory rights to public land. However, improvements made by a person on public lands are taxed as personal property.

Utah

Section 59-4-101, Utah Code Ann., imposes a tax on the beneficial use of tax-exempt property if the property is used in a business conducted for profit. The assessment, computation, and collection of the tax are identical to those of the ad valorem property tax. Utah law requires exclusive possession of the premises before the tax may be imposed. Ski areas in Utah are considered to have exclusive possession of the land even though others may use the land.[9]

Washington

Section 82.29A.030, Wash. Rev. Code, imposes a leasehold excise tax on the use of publicly owned real or personal property at the rate of 12% of taxable rent. Taxable rent is the amount due as payment for a leasehold interest when the lease agreement has been established under conditions

specified in Washington statute. The tax may not exceed what would be paid as an ad valorem tax on the market value of fee land.

Wyoming

Section 39-1-201, Wyo. Stat., exempts from property taxation property owned by the federal government, the majority of which is used for governmental purposes. A governmental purpose does not include improvements placed on federal land for private or commercial purposes. Wyoming law is similar to that of Idaho in that there is not a tax on the possessory interest in federal land, but the real and personal property of the user is subject to taxation.

Legal Analysis

At the Committee's February 2, 1996, meeting, Lee Heiman, Committee legal advisor, presented a memorandum[10] that concluded that under Montana law, a ski area with a contractual right to use federal property would be subject to the beneficial use tax. The amount of the tax would be based on the value of the use that is established through the terms of the contract. Pat Melby, an attorney representing the Montana Ski Areas Association, generally agreed with Mr. Heiman's analysis, but he disputed the Department's intention to impose the tax on the full value of land leased by a ski area. In order to do this, the ski area would have to have exclusive use of the property. However, Forest Service permits specify that the land may be used for other purposes.

The Committee asked whether an exemption for ski areas from the beneficial use tax would jeopardize the tax on the beneficial use of the BPA power lines. Mr. Heiman and David Woodgerd did not believe an exemption for ski areas would necessarily impair the tax. However, if exemptions are continually allowed, the tax may be discriminatory. Director Robinson said that the Department believes that ski areas are subject to the tax but that it would not impose the tax until the issue has been evaluated in cooperation with the ski areas and until the Legislature has an opportunity to consider the issue. The Committee postponed action pending further discussions between the Department and the Montana Ski Areas

Association.

Committee Action

At the August 26, 1996, meeting, Randy Wilke, Bureau Chief, Property Assessment Division, Department of Revenue, informed the Committee that the Department, in the absence of legislative action, would value and apply the beneficial use tax on ski areas located on public land. Senator Foster asked Director Robinson what the Department's position would be if the Legislature exempted ski areas from the beneficial use tax. Director Robinson said that the Department would not take a position.[11]

The Committee requested that staff prepare draft legislation that would exempt certain recreational uses of public lands from the beneficial use tax. The Committee directed staff to provide for an exemption only in the case in which the use is nonexclusive.

At the Committee's September 19 meeting, Lee Heiman presented LC 0101, which would exempt recreational leases from the beneficial use property tax. In 15-1-101, MCA, "recreational" would be defined to mean hunting, fishing, swimming, boating, water skiing, camping, biking, hiking, and winter sports, including but not limited to skiing, skating, and snowmobiling. The bill would amend 15-24-1203, MCA, as follows:

> **15-24-1203. Privilege tax on industrial, trade, or other business use of tax-exempt property -- exceptions.** (1) There is imposed and must be collected a tax upon the possession or other beneficial use for industrial, trade, or other business purposes enjoyed by any private individual, association, or corporation of any property, real or personal, that for any reason is exempt from taxation. ~~The tax may not be imposed upon the possession or other beneficial use of buildings owned by public entities and located upon public airports. However, privately owned buildings located on public airport property are subject to tax. The tax may not be imposed upon the possession or other beneficial use of public lands occupied under the terms of mineral, timber, or grazing leases or permits issued by the United States or the state of Montana or upon any easement unless the lease, permit, or~~

~~easement entitles the lessee or permittee to exclusive possession of the premises to which the lease, permit, or easement relates.~~ The tax is imposed upon the possession or other beneficial use of an electric transmission line and associated facilities, except that lines and facilities of a design capacity of less than 500 kilovolts are not subject to the tax.

(2) The tax may not be imposed upon:

(a) the possession or other beneficial use of railroad right-of-way or track owned by the United States or acquired by the state pursuant to Title 60, chapter 11, part 1, as long as the state or the United States retains ownership and the right-of-way or track is used exclusively for rail transportation~~.~~;

(b) ~~The tax may not be imposed on~~ the beneficial use by a person of property held by a port authority, created under Title 7, chapter 14, part 11, or by a port authority owned by the United States or an agency of the United States, unless the port authority provides for the exclusive use of the property by the person;

(c) the possession or other beneficial use of public lands occupied under the terms of recreational, mineral, timber, or grazing leases or permits issued by the United States or the state of Montana or upon any easement unless the lease, permit, or easement entitles the lessee or permittee to exclusive possession of the premises to which the lease, permit, or easement relates; or

(d) the possession or other beneficial use of buildings owned by public entities and located upon public airports. However, privately owned buildings located on public airport property are subject to tax.

The bill would be effective on passage and approval and would apply retroactively to tax years beginning after December 31, 1996. The Committee voted unanimously that the bill be introduced by the request of the Committee.

ALLOCATION OF THE METAL MINES TAX

Introduction

Three bills (Senate Bill No. 46, Senate Bill No. 382, and House Bill No. 569) that affected the allocation of the metal mines license tax under 15-37-117,

MCA, were passed and approved during the 1995 Legislative Session. The three bills were coordinated in an attempt to ensure the proper allocation of metal mines taxes. Unfortunately, the effect of a coordination instruction in Senate Bill No. 382 resulted in an overallocation of the metal mines tax effective July 1, 1997. For metal mines production occurring in calendar year 1997, 15.5% of metal mines taxes will be allocated to the resource indemnity trust fund. The amount that should be allocated is 8.5%. This section briefly summarizes recent

legislative history of the metal mines tax and diversions of the resource indemnity trust tax from the resource indemnity trust fund, gives options that would correct the overallocation, and reports on the Committee's action to correct the overallocation.

Recent History of the Metal Mines Tax

During the 1989 Regular Session, the Montana Legislature revised the taxation of metal mines (Ch. 672, L. 1989) and the allocation of revenue from the tax. Under the revised version of the tax, the gross value of product of concentrate in excess of $250,000 is taxed at 1.81% and the gross value of product of dore, bullion, or matte in excess of $250,000 is taxed at 1.6%. Previously, metal mines were taxed on increments of production in excess of $250,000 to more than $1 million at rates ranging from 0.5% to 1.5%. The legislation exempted metal mines production from the resource indemnity trust tax but provided an allocation of 15.5% of total collections to the resource indemnity trust fund.

During the 1991 Regular Session, the Legislature enacted Senate Bill No. 94 (Ch. 769, L. 1991), creating the ground water assessment program for the protection and management of ground water quality in Montana. The program is funded by the newly named resource indemnity trust and ground water assessment tax (14.1% of the proceeds from the tax). The use of the tax for a state program was the first diversion of the tax from the resource indemnity trust fund. Previously, all proceeds from the resource indemnity trust tax were deposited directly into the trust fund. Only interest earnings

from the trust fund were available for certain state programs.

Beginning July 1, 1993, the Montana Bureau of Mines and Geology was authorized to spend up to $666,000 to administer the program. However, the program received significantly less than that amount because revenue from the resource indemnity trust tax was less than anticipated. In addition, there was no provision in the legislation that created the program to divert metal mines tax allocated to the resource indemnity trust fund to the ground water assessment account.

Senate Bill No. 46 (Ch. 31, L. 1995) was enacted to correct the technical oversight in the original legislation. The new legislation reduced the allocation to the resource indemnity trust fund from 15.5% to 13.3% and provided a 2.2% allocation to the ground water assessment account established under 85-2-905, MCA.

A similar problem occurred in 1993 when the Montana Legislature enacted House Bill No. 608 (Ch. 478, L. 1993). The purpose of this act was to allocate a portion of the resource indemnity trust and ground water assessment tax to the renewable resource grant and loan program (15% of the proceeds beginning July 1, 1993, and 10% of the proceeds beginning July 1, 1995) and to the reclamation and development grants account (15% of the proceeds beginning July 1, 1993, and 30% of the proceeds beginning July 1, 1995). However, the legislation did not divert revenue from the metal mines tax to the renewable resource grant and loan program or to the reclamation and development grants account. The legislation also made several revisions in the allocation of interest earnings from the trust fund.

As was the case with Senate Bill No. 46, House Bill No. 569 (Ch. 577, L. 1995) was enacted to correct a technical oversight in the original legislation. Except for an allocation to the ground water assessment account, the introduced version of House Bill No. 569 would have allocated an amount of the metal mines tax in the same proportion as the resource indemnity trust and ground water assessment tax is allocated in 15-38-

106(2), MCA. The House of Representatives amended the bill to coordinate it with Senate Bill No. 46 to ensure that the metal mines tax allocated for resource indemnity trust tax purposes is distributed in the same proportion as other resource indemnity trust and ground water assessment taxes are distributed. The Senate removed the metal mines tax allocation to the renewable resource grant program (1.5%) and increased the allocation to the resource indemnity trust fund (from 7.2% to 8.5%) and to the reclamation and development grants program (from 4.6% to 4.8%). The Senate also voided the percentage allocation to the resource indemnity trust fund contained in Senate Bill No. 46.

The overallocation of the metal mines tax occurred with the enactment of Senate Bill No. 382 (Ch. 584, L. 1995). In part, Senate Bill No. 382 created a "mixed funding pilot program" for the voluntary cleanup of three sites from the Department of State Lands' (now the Department of Environmental Quality) abandoned hard-rock mine priority list. Under the pilot program, an owner of mining property is entitled to a reimbursement from the abandoned mines state special revenue account for eligible costs associated with the cleanup. Funding for the reimbursement is provided by 8.5% of the metal mines tax (the amount that would have gone to the resource indemnity trust fund). However, the Legislature did not provide for an appropriation to pay for the program.

The coordination instruction in Senate Bill No. 382 voided the percentage allocation to the resource indemnity trust fund contained in House Bill No. 569. In addition, the mixed funding pilot program terminates June 30, 1997. As a result of these two amendments in Senate Bill No. 382, the allocation of the metal mines tax to the trust fund returns to 15.5%. Because of the oversight in the coordination of Senate Bill Nos. 46 and 382 and House Bill No. 569, the allocation of the metal mines tax is 107% of total collections. This ingenious method for creating money would likely be thwarted by the Department when it attempts to dole out the proceeds of the tax in the next biennium.

Recommendations

Committee staff presented three options to the Committee to correct the latest technical oversight. The most efficient approach would be to specify that 15.5% of the proceeds from the metal mines tax be allocated as provided in 15-38-106(2), MCA. The allocation of the metal mines tax for the purposes of the resource indemnity trust tax would occur in 15-38-106, MCA, and not in 15-37-117, MCA. The distribution of oil and natural gas production taxes under 15-36-324, MCA, for the purposes of the resource indemnity trust tax is allocated under 15-38-106, MCA. This would alleviate the problem of having to revise the metal mines tax allocations each time that there is a change in the diversion of the proceeds from the resource indemnity trust tax. This approach, however, would be contrary to the policy choice made by the 1995 Legislature when it eliminated the metal mines tax distribution to the renewable resource grant program. The next Legislature may also decide to continue the mixed funding mine cleanup program, in which case the generalized allocation may be cumbersome.

The most practical approach would be to reduce the allocation of the metal mines tax to the resource indemnity trust fund from 15.5% to 8.5%, effective July 1, 1997. That change would probably be consistent with legislative intent for the distribution of metal mines taxes. The Legislature would have to be watchful to ensure that similar technical oversights do not happen again.

Committee staff pointed out that the easiest approach would be to do nothing on the assumption that legislation will be introduced as a matter of course in which the problem will be corrected.

Committee Action

At the Committee's August 26 meeting, staff presented two bill drafts for correcting the overallocation of the metal mines tax. The first, LC 0077, would simply reduce the amount of the metal mines tax allocated to the resource indemnity trust fund from 15.5% to 8.5%. The second, LC 0077.02, would allocate 15.5% of the metal mines tax in the same manner as all other resource indemnity and ground water assessment taxes are allocated as provided in 15-38-106, MCA. At the time, the Committee

concluded that it did not have enough information and postponed action until the next meeting. At the September 19 meeting, the Committee voted unanimously that LC 0077.02 be introduced by the request of the Committee.

RAILROAD CAR TAX SETTLEMENT AND TAX SETTLEMENT ISSUES

Railroad Car Tax Settlement

In January 1992, several railroad car companies sued in federal court, challenging Montana's freight line company tax on the grounds that the tax was discriminatory under the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). The freight line tax imposed a 5.5% tax on the gross earnings of railroad car companies operating within the state. The tax was in lieu of all other taxes and was deposited in the state general fund. Because similar taxes in other states had been overturned, the Department requested legislation during the July 1992 Special Session to repeal the freight line company tax and to impose a statewide property tax on railroad car companies. At about the same time, a federal magistrate in Billings issued a decision that the freight line tax violated the 4-R Act.[12]

The Legislature enacted House Bill No. 24 (Ch. 10, Sp. L. July 1992) to tax railroad car company property as class twelve property. The new method of taxing railroad car companies applied to tax years beginning after December 31, 1990. Because the freight line tax had been overturned, the retroactive application of the new tax ensured that railroad car companies paid taxes in tax years 1991 and 1992. Revenue from the new tax is deposited in the state general fund.

The new tax was challenged by railroad car companies in May 1993 when the first payment of the tax became due. As was the case with the freight line tax, the railroad car companies claimed that the state's new method of taxing railroad cars violated federal prohibitions against discriminatory taxation under

the 4-R Act. The railroad car companies argued that the allocation mechanism and the retroactive application of the tax were illegal.[13] During the 1995 Legislative Session, Senator Del Gage introduced Senate Bill No. 257. The bill would have revised the value of railroad cars allocated to Montana based on speed (i.e., the number of railroad car miles traveled per day in the state). The purpose of the bill was to provide a framework for negotiations between the Department and the railroad car companies. The Legislature revised the original allocation method contained in Senate Bill No. 257. That change caused Governor Marc Racicot to veto the bill. In his veto message, the Governor wrote that the railroad car . . . "companies have unequivocally expressed their aversion to settle the case on the basis of the provisions of Senate Bill 257".[14]
U.S. District Court Judge Jack Shanstrom ordered a settlement conference between the Department and the affected railroad car companies, under the supervision of Judge Richard Anderson, federal Magistrate in Billings. At the March 29, 1996, Committee meeting, Mick Robinson informed the Committee that the Department had reached a tentative settlement with several railroad car companies regarding the taxation of railroad cars in the state.

Director Robinson presented a memorandum[15] in which he informed Governor Racicot that the Department had resolved the issues in ACF Industries, Inc. v. Department of Revenue, Cause No. CV-93-74, and had reached an agreement with the railroad car companies 15 concerning the taxation of railroad cars in Montana. According to the memorandum, the essential elements of the agreement included the following:

1. a refund of taxes, plus accrued interest, paid under protest by the railroad car companies for tax years 1991 and 1992. Taxes assessed in these tax years applied retroactively.

15 The other railroad care companies include Detroit Edison, GATX, GE Railcar, Railgon, TTX, and Union Tank.

2. the adoption of the 100% speed approach to determine equivalent cars, by class, in Montana. The speed for intermodal and unit cars was set at 450 miles a day. The speed for other railroad cars was set at 200 miles a day for tax years 1993 through 1995 and 250 miles a day for tax years 1996 through 2002.

3. an adjustment to the statewide average mill levy for commercial and industrial property. For tax years 1993 through 1995, the mill levy would be 90% of the commercial and industrial levy. For tax years 1996 through 2002, the mill levy would be 95% of the commercial and industrial levy.

Under the agreement, the railroad car companies would receive a refund of approximately $3.1 million, plus accrued interest, for tax years 1991 and 1992. In the order granting summary judgment, issued October 13, 1995, Judge Shanstrom ruled that the Department could not collect railroad car taxes assessed retroactively against the railroad car companies. The judge ordered a refund of those taxes. As part of the settlement, the Department agreed to withdraw its appeal of the summary judgment to the Ninth Circuit Court of Appeals. Also under the agreement, the state general fund would receive $4.8 million, plus accrued interest, for taxes paid under protest in tax years 1993 through 1995. In addition, the Department estimated that tax receipts for tax year 1996 would amount to $1.7 million.

The Department, however, withdrew from the settlement following the U.S. Supreme Court decision in Seminole Tribe of Florida v. Florida, ___U.S.___, 134 L. Ed. 2d 252, 116 S. Ct. 1114 (1996). The decision addressed the issue of whether an Indian tribe may sue a state in federal court to enforce certain provisions of the Indian Gaming Regulatory Act, passed by Congress pursuant to the Indian Commerce Clause. Under the Act, states have a duty to negotiate with a tribe "toward the formation of a compact" that would allow the Indian tribe to conduct certain gaming activities in the state. If a state does not negotiate a compact in good faith, an Indian tribe may,

under 25 U.S.C. 2710(d)(7), bring action in federal court. The U.S. Supreme Court held that the 11th amendment[16] to the U.S. Constitution "prevent[s] Congress from

authorizing suits by Indian tribes against States . . . to enforce legislation enacted pursuant to the Indian Commerce Clause". The decision noted that the Supreme Court has allowed the abrogation of a state's 11th amendment immunity under only two constitutional provisions: the 14th amendment and the Interstate Commerce Clause as decided in Pennsylvania v. Union Gas Co., 491 U.S. 1, 105 L. Ed. 2d 1, 109 S. Ct. 2273 (1989). The Court concluded, however, that Union Gas was a departure from "established law" and that the decision was wrongly decided. The Court, in fact, overruled Union Gas in Seminole.

Although Seminole addressed the narrow issue of Indian gaming, the overruling of Union Gas has broader implications regarding lawsuits against states in federal court. On first blush, the decision apparently prevents federal court jurisdiction in the railroad car issue. Accordingly, as previously noted, the Department withdrew from the settlement and filed a motion in federal District Court to dismiss the entire case. Conversely, the railroad car companies filed a motion to amend their complaint to name the Director of the Department as defendant so that the case could proceed in federal court.

At a May 17, 1996, hearing in Billings, Judge Shanstrom granted a preliminary injunction against collection of the tax by the Department. In addition, the judge set a hearing date for June 25, 1996, to consider oral arguments regarding the separate motions of the parties. However, during a conference call with the parties on May 25, 1996, Judge Shanstrom

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16 The 11th amendment to the U.S. Constitution provides: "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state.

denied the Department's motion to dismiss on the grounds that the state had implicitly waived its 11th amendment immunity by agreeing to the settlement. At the same time, the railroad car companies withdrew their motion to amend. Judge Shanstrom issued a formal decision denying the Department's motion to dismiss.[17] At the October 18, 1996, meeting, Director Robinson, informed the Committee that the Department had signed the previously negotiated agreement with the railroad car companies.

Statutory Authority to Enter Into Tax Settlements

Also at the March 29 Committee meeting, Greg Petesch, Director, Legal Services Office, Legislative Services Division, reviewed several issues related to the railroad car settlement, in particular, and generally discussed the scope of the authority of the Department to enter into tax settlements. The following summarizes the issues identified by Mr. Petesch:

1. The railroad car settlement is in effect through tax year 2002. The state has established how it will tax railroad cars through a settlement agreement that will span three legislative sessions. To that extent, the Legislature should be concerned about the authority of the Department to bind the state for future time periods.

2. The Department revised the statutory mill levy to be used in taxing railroad cars. It is a general rule of administrative law that agencies may not, through administrative procedures, change statutes. To the extent that settlement agreements are unique, the general rule may be legitimate. However, the Department could have established a method of

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[17] In a separate class action lawsuit involving several, smaller railroad car companies, Judge Shanstrom dismissed the Department of Revenue as a party to the case but allowed the railroad car companies to amend the complaint to name Mick Robinson as defendant (Chrysler Rail Transportation v. Department of Revenue, Cause Nos. CV 93-080-BLG-JDS and CV 93-207-BLG-JDS).

resolving tax liability without attempting to negotiate a tax rate.

3. The Legislature should be concerned because of the scope of authority that the Legislature has granted to the Director of the Department to enter into settlement agreements. There is no requirement in statute that a settlement be limited to a disputed tax or that taxes be paid under protest. The agreement demonstrates the broad delegation of authority to settle with taxpayers who can persuade the Department to enter into an agreement with them. For example, a taxpayer could negotiate a settlement on income tax rates and the Department would be bound by that agreement.[16]

With respect to point 1 above, the Department essentially exercised legislative prerogatives by settling prospectively and by agreeing to a "termination" date for the tax. The state may have been better served had the Department settled on prior tax years and presented legislation to the 1997 Legislature for prospective taxes. Any proposed legislation could have contained the essential elements of the agreement but would have ensured appropriate legislative deliberation.

With respect to point 2 above, the Department apparently reinterpreted a statutory provision regarding the applicable mill levy. Section 15-23-211(1), MCA, provides that the ""[a]verage levy" means the average statewide rate of taxation on commercial and industrial property". At the March 29 meeting, Director Robinson argued that the proper interpretation of the "average levy" means that the statewide average mill levy for commercial and industrial property has to be adjusted to reflect the average levy for other railroad property.[17] The rationale for that interpretation was the fact that railroad cars are not operated in every county.

When the new method of taxing railroad cars was passed during the July 1992 Special Session (Ch. 10, Sp. L. July 1992), the levy applied to railroad

cars was the average statewide levy assessed against motor vehicle fleets under 15-24-103, MCA. During the 1993 Regular Session, the House Taxation Committee introduced a Committee bill (House Bill No. 640), at the request of the Department, to revise the definition of the average levy to what it now is under current law. Department testimony and the fiscal note presented in support of the bill did not demonstrate that the average industrial and commercial levy included a specific adjustment to reflect the tax rate on other railroad property. The bill was enacted as introduced (Ch. 532, L. 1993).

To reiterate the point made by Mr. Petesch, the Department could have devised a method of resolving tax liability by means other than a negotiated tax rate. For example, the Department, under its rather broad rulemaking authority in 15-23-213(2), MCA, could have negotiated, for settlement purposes, a different speed formula for the various types of railroad cars that could have achieved basically the same result. By pursuing such an alternative, the Department could have accomplished its objectives without usurping, perhaps unconstitutionally, legislative authority.

With respect to point 3 above, 15-1-211, MCA, authorizes the Department to enter into negotiated settlements. This section was enacted in 1991 (Ch. 811, L. 1991). The relevant provisions of the section under discussion are:

> **15-1-211. (Temporary) Uniform tax review procedure -- notice -- appeal.** (1) The department of revenue shall provide a uniform tax review procedure for all taxpayers, except as provided in subsection (1)(a).
>
> (a) The tax review procedure described in this section applies to all taxes administered by the department except inheritance taxes, estate taxes, and property taxes. **The procedure applies to any revised assessment of centrally assessed property taxed pursuant to chapter 23.** (Emphasis added)

> (b) The term "taxpayers", as used in this section, includes all persons determined by the department to have a potential tax liability.
>
> . . . (8) (a) **The director of revenue or his designee is authorized to enter into an agreement with any taxpayer relating to the taxpayer's liability with respect to a tax administered by the department for any taxable period.**
>
> **(b) An agreement under the provisions of subsection (8)(a) is final and conclusive, and, except upon a showing of fraud, malfeasance, or misrepresentation of a material fact:**
>
> **(i) the agreement may not be reopened as to matters agreed upon or be modified by any officer, employee, or agent of this state; and**
>
> **(ii) in any suit, action, or proceeding under the agreement or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance with the agreement, the agreement may not be annulled, modified, set aside, or disregarded.** (Emphasis added)

The language contained in subsection (8) regarding "an agreement with any taxpayer relating to the taxpayer's liability . . . for <u>any</u> taxable period" implies that an agreement could cover taxes that already have been assessed or that may be assessed in the future. The text of ARM 42.2.611 refers to disputed taxes for settlement purposes. It also states that "[a] settlement is not binding on the taxpayer or the department concerning other tax years or other taxpayers". Under the Department's own rule, it would seem that the settlement must cover a disputed tax--that is, a tax liability already incurred.

Settlements of disputed taxes that involve specific dollar amounts or that involve other types of arrangements outside statutory provisions are common and compatible with established administrative procedures. In that regard, the provisions of 15-1-211(8)(b), MCA, that prohibit reopening the matter or annulling the agreement are appropriate. However, when those prohibitions apply to a prospective tax settlement, legislative power is diminished. It is the Legislature's responsibility to enact defensible tax policy and that responsibility should not be diminished.

Recommendations

The 4-R Act limits the states' ability to tax railroad property. The states' methods of taxing railroad property have been routinely challenged in federal courts. It is possible that the federal courts would have invalidated Montana's railroad car tax. Given the Department's assessment of the likelihood of that occurrence, it was appropriate to enter into an agreement with the railroad car companies, particularly with respect to prior year taxes. Under current law, the Department also has the authority to settle prospectively. The Legislature should be concerned about Executive Branch abrogation of legislative authority regardless of the issue.

Committee staff recommended that the Committee consider two separate changes to existing law to deal with the issues raised by the railroad car settlement. The first would be to clarify the definition of the average levy, specified in 15-23-211, MCA, as applied to railroad car property. The other would be to revisit 15-1-211, MCA, to determine whether the Legislature granted appropriate powers to the Department. In particular, staff asked whether the Committee wanted to consider legislation that would limit the Department's authority to enter into tax settlements that involve only disputed or protested taxes.

Committee Action

At the June 24 meeting, the Committee requested draft legislation to revise the average mill levy applied to railroad car property and to limit the authority of the Department to enter into prospective tax agreements.

<u>Revised definition of average levy</u>: Committee staff presented one bill draft (LC 0078.01) that would clarify that the average mill levy applied to railroad car property is the average statewide levy for commercial and industrial property. The other bill draft (LC 0078.02) would clarify that the average mill levy applied to railroad car property is the average statewide levy applied to railroad transportation property, other than railroad car property. At its September 19 meeting, the Committee asked Dave Woodgerd which proposal the Department would prefer as a negotiating tool with the railroad car companies. Mr. Woodgerd said that the average mill levy applied to other railroad property would be more in line with the agreement that

was part of the original settlement. The average mill levy applied to commercial and industrial property corresponds to what the Department assumed was the law and "may have some advantage until the Department sees what happens with the current lawsuits".[18] The Committee voted to adopt LC 0078.01.

At the October 18, 1996, meeting, Director Robinson informed the Committee that the Department had decided not to appeal Judge Shanstrom's denial of the Department's motion to dismiss and had signed the tax settlement with the railroad car companies. As a result, the Committee suspended its previous approval of LC 0078.01 until its final meeting.

<u>Limit authority of Department to enter into prospective tax settlements</u>: At the August 26, 1996, meeting, staff presented a bill draft (LC 0079) that would revise the conditions under which the Department may enter into tax agreements with taxpayers. The bill would amend 15-1-211, MCA, and would generally limit agreements to instances in which a taxable event has occurred. The bill would allow the Department to enter into agreements related to the method of filing tax returns. The method of filing agreements for tax returns could be prospective in nature.

Director Robinson told the Committee that tax settlements involve complex issues and that the Department needs "more tools" for the purposes of tax administration. He said that settlement issues related to the taxation of corporate net income (e.g., method of filing and nexus and apportionment), the taxation of centrally assessed property (e.g., method of property valuation), and the taxation of natural resources (e.g., the valuation of extracted mineral) often require that certain matters be agreed to prospectively. Absent the flexibility to settle prospectively, many more tax disputes would have to be resolved through litigation.[19] Terry Cosgrove, Attorney, Crowly Haughey Hanson Toole & Dietrich, said that the authority of the Department to settle prospectively is very important. He said that the certainty of the tax is often more important than the amount of the tax. Prospective agreements allow taxpayers to plan for the future.[20]

Based on the foregoing testimony, the Committee decided to take no action on the bill draft.

COAL SEVERANCE TAX LITIGATION

At the November 17, 1995, meeting, Clay Smith, Solicitor, Montana Department of Justice, reported on the latest round of litigation related to the Crow Indian Tribe lawsuit for refund of coal severance taxes and coal gross proceeds taxes. The lawsuit has a long and complicated history dating back to 1978 when the Crow Tribe filed for a declaration that Montana's coal severance tax and coal gross proceeds taxes were preempted by federal law for coal produced on the Crow Indian Reservation as well as on the Ceded Strip. The Ceded Strip, originally part of the reservation, was opened to homesteading by an act of Congress in the first decade of this century. The mineral rights, however, remained with the tribe. In January 1983, the U.S. District Court in Billings required that coal severance taxes imposed on Westmoreland Resources, Inc., for coal produced on the Ceded Strip be deposited in an escrow account until the lawsuit was settled. In 1987, the court provided the same relief with respect to coal gross proceeds taxes. Also in that year, the Ninth Circuit Court of Appeals held that Montana's coal taxes imposed against coal production on the Ceded Strip were invalid. As a result, severance tax payments of about $23.4 million and coal gross proceeds tax payments of a little over one-half million dollars, plus accumulated interest, were turned over to the tribe from the escrow accounts.

However, the tribe is still seeking restitution for severance taxes paid between 1976 and 1983 and for coal gross proceeds taxes paid to Big Horn County between 1975 and 1987. In addition, the tribe is seeking damages for economic loss associated with the cancellation of a lease agreement with Shell Oil that the tribe claims was caused by the imposition of coal taxes.

Mr. Smith said that in November 1994, Judge Shanstrom dismissed the

tribe's claim for retroactive relief for coal taxes paid by Westmoreland and for damages associated with cancellation of the lease with Shell Oil. The Crow Tribe appealed that decision to the Ninth Circuit Court of Appeals. Mr. Smith also described the fiscal impact related to the principal amount of taxes in dispute plus prejudgment interest. As of March 31, 1994, the total amount that could be refunded to the tribe for the coal severance tax would be $264 million and for the coal gross proceeds tax would be $52.8 million.

At a subsequent meeting (August 26, 1996), Mr. Smith informed the Committee that a three-member panel of the Ninth Circuit Court of Appeals reversed the U.S. District Court denial of relief to the Crow Indian Tribe for the restitution of taxes paid by Westmoreland. The court, however, affirmed the denial of the claim that the state, by imposing the coal severance tax, had interfered with the Crow Tribe's contractual and business relationship with Shell Oil for the development of a coal mine on the reservation. The case was remanded to the U.S. District Court in Billings for determination of prejudgment interest on the taxes paid. According to figures provided by Mr. Smith, the total liability to the State of Montana for the restitution of coal severance taxes and coal gross proceeds taxes could be in excess of $300 million.[21]

Mr. Smith told the Committee that the state will request a rehearing of the opinion before an en banc panel of the Ninth Circuit Court. He said that the state and Big Horn County have substantial defenses, as a matter of law, to the restitution claim. In addition, the panel did not address the state's defense that the tribe is not entitled to tax money that it did not pay. According to Mr. Smith, only an en banc panel may address that issue. If the state is not granted a rehearing, it will appeal to the U.S. Supreme Court.

The Committee asked how restitution would be accomplished if the state loses and whether Big Horn County would be liable for the restitution of coal gross proceeds taxes. Mr. Smith said that the state could tap the coal

severance tax trust fund[18] or impose a separate tax. Mr. Smith said that he did not know who would have legal responsibility to repay coal gross proceeds taxes. John Doyle, Commissioner, Big Horn County, requested that the state assist Big Horn County if the Crow Tribe prevails. Rod Svee, Superintendent of Schools, Hardin, said that a number of court cases have considered as state money coal gross proceeds taxes paid on coal mined on the Crow Indian Reservation.[22]

Mr. Smith informed Committee staff that the petition for rehearing has been accepted for filing.[23] The full membership of the Ninth Circuit Court of Appeals must vote to determine whether a rehearing en banc is granted. The restitution of coal severance taxes and coal gross proceeds taxes may not have to be considered by the 55th Legislature. However, if the Crow Indian Tribe ultimately prevails, the state will be faced with the daunting and contentious task of repaying taxes collected long ago, as well as accrued interest. 6345loxa.

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18 Principal on the trust fund may not be expended unless appropriated by three-fourths of the members of each house of the Legislature.

ENDNOTES

1. Letter from Patrick E. Melby, Luxan & Murfitt, to George Willett, Showdown Ski Area, April 25, 1995, p. 4.

2. Memorandum Opinion (REV/OLA 95-05) from Paul Van Tricht, Tax Counsel, Office of Legal Affairs, Department of Revenue, to Mary Whittinghill, Administrator, Property Assessment Division, Department of Revenue, September 12, 1995.

3. See Memorandum (Application of Beneficial Use Tax to Ski Areas) from Lee Heiman, Staff Attorney, to the Revenue Oversight Committee, February 2, 1996, pp. 1-4, in Minutes, Revenue Oversight Committee, February 2, 1996, EXHIBIT #9.

4. House Ways and Means Committee, Minutes, January 1, 1969, p. 1.

5. Heiman, op. cit., p. 4.

6. Senate Taxation Committee, Minutes, February 17, 1993, p. 1.

7. Senate Taxation Committee, Minutes, March 4, 1993, p. 11.

8. Possessory Interest Taxation in Other States: Interim Summary of Survey Responses (Albany, NY: New York State Division of Equalization and Assessment, November 11, 1992).

9. Sheldon Drapper, Property Tax Division, Utah Tax Commission, telephone conversation, January 26, 1996.

10. Heiman, op. cit.

11. Minutes, Revenue Oversight Committee, August 26, 1996, pp. 17 and 18.

12. Memorandum (Rail Car Tax Report) from Mick Robinson, Director, Department of Revenue, to the Revenue Oversight Committee, January 30, 1996.

13. Ibid.

14. Governor Marc Racicot, letter (veto message of Senate Bill No. 257) to President of the Senate Bob Brown and Speaker of the House John Mercer, May 12, 1995.

15. Memorandum (Settlement of ACF Industries, Inc. v. Dept. of Revenue) from Mick Robinson to Governor Marc Racicot, March 13, 1996, in Minutes, Revenue Oversight Committee, March 29, 1996, EXHIBIT #6.

16. Minutes, Revenue Oversight Committee, March 29, 1996, Montana Legislative Services Division, pp. 19 and 20.

17. Minutes, Revenue Oversight Committee, March 29, 1996, p. 20.

18. Minutes, Revenue Oversight Committee, September 19, 1996, p. 15.

19. Minutes, Revenue Oversight Committee, August 26, 1996, pp. 20 and 21.

20. Ibid, p. 21.

21. Ibid, p. 3.

22. Ibid., pp. 5 and 6.

23. Clay Smith, Solicitor, Montana Department of Justice, telephone conversation, November 7, 1996.

APPENDIX A

MOTOR VEHICLE TAXATION GROUP

Project Team:

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Sharon Ferguson, Property Assessment Division, Department of Revenue

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> Steve Turkiewicz, Executive Director, Montana Automobile Dealers Association

> Dan Wirak, Mergenthaler's Transfer and Storage Co.

Ben Havdahl, Executive Vice President, Montana Motor Carriers Association

Bob Gilbert, Montana Tow Truck Association

Dale Clark, Montana Grain Growers Association

Governmental Agencies

David Galt, Motor Carrier Services Division, Department of Transportation

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Randy Wilke, Property Assessment Division, Department of Revenue

Stan Hughes, Montana Treasurers Association

> Denotes also member of project team

APPENDIX B

APPENDIX C