



**Joint Subcommittee on The Changing Economy and Impacts
to the Long-Term Viability of Montana's Tax Structure
65th Montana Legislature**

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MEMBERS

Rep. NANCY BALLANCE
Sen. DICK BARRETT
Sen. MARK BLASDEL
Rep. KIMBERLY DUDIK
Rep. JIM HAMILTON

MEMBERS

Rep. GREG HERTZ
Rep. TOM JACOBSON
Sen. LLEW JONES
Sen. FREDERICK (ERIC) MOORE
Sen. JON SESSO

COMMITTEE STAFF

AMY CARLSON, Legislative Fiscal Analyst and Director
MEGAN MOORE, Research Analyst

MINUTES

Jan. 17, 2018
Room 152, Capitol Building
Helena, Montana

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Please contact the Legislative Services Division at 406-444-3064 for more information.

COMMITTEE MEMBERS PRESENT

SEN. DICK BARRETT
SEN. MARK BLASDEL
SEN. LLEW JONES
SEN. FREDERICK (ERIC) MOORE
SEN. JON SESSO

REP. NANCY BALLANCE
REP. KIMBERLY DUDIK
REP. JIM HAMILTON
REP. GREG HERTZ
REP. TOM JACOBSON

COMMITTEE MEMBERS EXCUSED

STAFF PRESENT

AMY CARLSON, Legislative Fiscal Analyst and Director
MEGAN MOORE, Research Analyst
KAREN GILBERT, Committee Secretary

VISITORS' LIST ([Attachment 1](#))

AGENDA ([Attachment 2](#))

COMMITTEE ACTION

The subcommittee decided to further discuss topics with both full respective committees (Legislative Finance Committee and Revenue and Taxation Interim Committee) and convene for a four-hour joint session on March 12, 2018.

CALL TO ORDER and ROLL CALL

00:00:04 Rep. Jacobson called the meeting to order at 1 p.m. on Wednesday, Jan. 17 2018 in room 152 of the State Capitol. The subcommittee secretary took the roll. ([Attachment 3](#))

ADMINISTRATIVE MATTERS

Election of Presiding Officer(s)

00:01:05 Rep. Jacobson said the subcommittee was comprised of members of two committees, House and Senate and both parties.

00:01:11 Rep. Ballance said the subcommittee needed it identify objectives and goals and that there may be no reason for it to go on after a March joint meeting of the two committees. She recommended assigning a chairman for the subcommittee and nominated Sen. Jones.

00:02:43 With no objections, Sen. Jones was assigned as subcommittee chair.

Operating Procedures and Membership

00:03:45 Chair Jones briefly noted the operating procedures and rules document provided by Legislative Services and said most members have already served on interim committees and were familiar with the procedures. No one objected to not reviewing the document. ([Exhibit 1](#))

COMMITTEE GOALS AND PURPOSE

General overview of LFC original goals

- 00:04:47 Director Amy Carlson, Legislative Finance Committee, presented a general overview.
- 00:05:24 Chair Jones said the LFC is consistently trying to balance the budget to an ever-changing revenue source that is increasingly volatile. He said the main street economy has changed, and while Montana is good at measuring bushels of wheat and other traditional sources of revenue, areas like medical and e-commerce services aren't participating in the economy. He said other states face the same problem. He said the LFC isn't a tax committee but it is interested in a narrow subset of taxes.
- 00:09:22 Rep. Ballance asked to hear from RTIC regarding their goals.
- 00:09:38 Rep. Jacobson said the RTIC has had a couple of discussions on the topic including where will the state be in 2021. He said RTIC had discussed putting together a study on how to raise revenue in the state in an equitable and fair manner. But he said what he is hearing now is that they want to come up with policy for the 2019 session. He asked if the purpose of this joint committee is to identify a number of policies to move forward? He said how will they know they've accomplished what they set out to do?
- 00:11:51 Chair Jones said it would be nice to have a visible solution. He said they first need to define what has changed, identify solutions, see what is out of balance. He said they need to look at areas that have seen massive growth, such as the medical services area.
- 00:14:09 Sen. Barrett said he would back up a step to define what the nature of the tax issue is. He said you could refer to it as stagnation in revenue growth. He said growth in relation to the economy has declined, they need to identify the sources of that phenomenon. He said he is not prepared to leap to the conclusion that what we are observing is the result of the kinds of structural changes Chair Jones described. A number of other structural and economic changes occurring are playing a role.
- 00:16:32 Chair Jones said he didn't disagree there are other factors involved. He said they still need to measure the "puck" and what has changed. He asked is South Dakota right that one out of every four dollars is e-commerce? He said until we start talking about where the money is, we can't talk about who should participate. From the LFC's perspective, he said they have to stay focused on efficient spending.
- 00:18:48 Rep. Ballance said it wasn't the LFC's goal to try to come up with a short term solution for revenue for 2019 or to increase revenues over a longer period of time, that is RTIC's role. But she said the spending and budget committee has to understand what is changing.
- 00:20:20 Sen. Sesso said this venue has some real value to glean and hear what the industry is saying. He said he appreciated Sen. Barrett's point of view that they don't know exactly what is going on, but they should resolve themselves to try to

help figure it out. He said his objective is to explore e-commerce, have it defined and to be constantly aware of the legal aspects of catching revenue from that source and how it could contribute to the larger pie. He said they should also look for areas to reduce. He said other states are sales tax states and Montana is not and he doesn't see a horizon where that will change. He said they should all resolve themselves to whatever happens, even a revenue neutral endeavor to the state. He said they should study how to re-structure so the high-growth sectors can contribute over the long-term.

- 00:24:46 Rep. Jacobson asked for clarification on the subcommittee's goal. He said everyone's time was valuable and they were spending taxpayer dollars.
- 00:25:58 Chair Jones said the subcommittee may need to revisit the discussion after they go over the background information on the agenda and hear from the guest presenter, Mark Haggarty of Headwaters Economics.
- 00:27:21 Rep. Ballance said for clarification it was not her goal to not come up with policy; but she was not interested in policy to grow revenue for 2019 or in the long term.
- 00:27:53 Chair Jones said the revenue growth or lack thereof debate will occur, but he said he'd like to have discussions about the underlying factors.
- 00:28:35 Dir. Carlson provided an introduction for the next section, noting they would not go through all the information during the meeting.

REVIEW BACKGROUND INFORMATION

Tax policy handbook for State Legislators

- 00:28:49 Megan Moore, research analyst, Legislative Services Office of Research and Policy Analysis, introduced the policy handbook. ([Exhibit 2](#))

LFD Research & Analysis

- 00:29:42 Stephanie Morrison, fiscal analyst, Legislative Fiscal Division, introduced research and analysis included in the subcommittee's binders. ([Exhibit 3](#))
- 00:31:59 Chair Jones asked about general fund revenue sources on the bottom of page 7.
- 00:32:30 Ms. Morrison said the chart on page 8 answered his question. She said the largest sources that have not kept pace with the percentages they had in the early 2000s are property tax, vehicle taxes and fees, and some other sources like interest earnings and revenue diversions.
- 00:33:27 Chair Jones said there were some voter-driven diversions and some school diversions.
- 00:33:43 Ms. Morrison said there had been some legislative policy decisions, voter

initiatives, underlying tax payer behavior, and changes in short term interest rates.

- 00:34:14 Chair Jones said this was not all necessarily a decline in collections, but diversions.
- 00:34:28 Ms. Morrison said; yes, an example is common school interest and income diverted to the guarantee account.
- 00:34:40 Chair Jones asked what portion was diversion and what portion was reduction.
- 00:35:10 Ms. Morrison said she would follow up on that question.
- 00:35:20 Sen. Barrett said the property tax declined in relation to GSP up to 2007-08; after that date the relationship stabilized.
- 00:35:43 Ms. Morrison agreed.
- 00:35:50 Rep. Hamilton asked Ms. Morrison about the table on page 8 on "other" business taxes and what that looks like over longer haul.
- 00:36:14 Ms. Morrison said it includes smaller income sources, also the retail telecommunications tax that has been declining for a number of years.
- 00:37:05 Rep. Dudik asked Ms. Morrison about the summary of inflation impacts: if they would have had a continual update, where would they be? She asked if there are there other inflationary increases that aren't included? She said during the session they looked at increasing court filing fees, are there other possibilities?
- 00:38:04 Ms. Morrison said they looked at fees that went into general fund. She said she was not sure if it was a comprehensive list, there are a variety of small random fees. She said they are probably not included in this analysis.
- 00:38:46 Chair Jones said he'd like information including the separation of diversions to other programs.

Survey results

- 00:39:20 Dir. Carlson briefly introduced the results of a survey that went to both committees regarding topics for the subcommittee to discuss. She noted it was not scientifically-created, 17 people responded. ([Exhibit 4](#))

Montana's Financial Volatility

- 00:39:58 Dir. Carlson discussed the financial volatility handouts. She said the LFD staff is preparing additional information for next meeting. ([Exhibit 5](#))
- 00:41:22 Chair Jones returned to the survey and listed the topic five topics for the

audience: e-commerce impacts on state revenue collections, research change over time of main street vs. online sales, service taxes, estimate fiscal impact of imposing a medical services tax, and estimate fiscal impact of expanding tourism related taxes.

00:42:02 Rep. Jacobson said since 17 of 24 members responded (he did not) he recommended a new survey after the subcommittee considers additional information and research. He said something not 30 questions long would be better.

00:42:56 Chair Jones said yes, this survey wasn't scientific, just quick survey.

00:43:11 Rep. Ballance said she had a question on financial volatility. She asked which revenue sources are most volatile?

00:44:39 Dir. Carlson said one of the pieces for the next LFC meeting touches on that question. She said federal tax policy affecting local is difficult, but they will have statistical analysis on it for the March meeting.

00:45:58 Rep. Dudik asked Dir. Carlson regarding the survey results, question no. 4 on medical services tax. She asked if that was a tax on the consumer of the services or a tax on the provider, that would be passed on to consumer.

00:46:38 Dir. Carlson said that choice would be up to the committee. She said it was not defined, just guidance for the committee.

Other

00:47:06 Jaret Coles, attorney, Legal Services Office, Legislative Services Division, went over federal constitutional provisions and topic primers. ([Exhibit 6](#))

The Changing Economy - Mark Haggerty, Headwaters Economics

00:54:20 Mr. Haggerty gave his presentation to the subcommittee. ([Exhibit 7](#))

01:19:22 Sen. Barrett asked Mr. Haggerty about how corporate income tax growth has not kept up with GSP and if he can relate that phenomenon to the structural shift the subcommittee is talking about.

01:20:59 Mr. Haggerty clarified: do different sectors pay different effective corporate income tax rates in relation to output and if that's true, is it consistent over time and should we expect more revenue? He said he did not have an answer for that question. He said the University of Chicago is looking at it.

01:21:50 Sen Barrett asked about a shift in a traditional sector to a sector like health care, is that going to affect individual income tax collections?

01:22:25 Mr. Haggerty said he didn't think so. He said the larger question is a sector's

total contribution to state revenue and other direct taxes on that sector's activities.

- 01:23:00 Sen. Barrett said his perception is every income stream is displaying same symptoms. He said if you have a million dollars worth of output from coal mining shifting to health care, there could be a difference in amount of personal income subject to taxation?
- 01:23:46 Mr. Haggerty said there is an argument to be made there. As productivity increases in health care sector, wages increase. He said labor-intensive sectors like nursing may end up paying a larger share of their contribution to GDP in personal income taxes. He said as you shift from capital-intensive to labor-intensive industries, it could be that personal income taxes would rise and make up for the loss in goods-production taxes.
- 01:24:35 Sen. Barrett asked if there is any indication that the structure of wages could have an effect if you went from industry with small number of highly paid employees to larger number of lower paid employees, but total wage bill was the same, they might be subject to different tax rates because of the structure of the tax system.
- 01:25:17 Mr. Haggerty agreed. He said income tax returns in some states have shifted. He said there are fewer individuals making higher wages paying a larger share of state personal income taxes. With a shift from wage and salary to other benefits, income tax returns have become more volatile.
- 01:25:59 Sen. Moore asked about definition of services vs. non-services labor income: an accountant for XYZ corporation is classified as non-services, but if that corporation contracts with accounting firm that same job is classified as services?
- 01:26:46 Mr. Haggerty said he was not sure of answer, he was referring to Bureau of Labor Statistics information. He said he did know if you work at accounting firm you will be a service provider, not sure if you are accountant at mining company.
- 01:27:21 Chair Jones said as the economy has evolved it is easier to measure Yellow Cab than Uber, we've increasingly seen a leak. Have you seen evidence of any such leak?
- 01:28:18 Mr. Haggerty said he hasn't looked at it.
- 01:28:25 Chair Jones asked about the elasticity of income tax. He said wealth used to be associated with real property, but now people can chose to live wherever. Has income tax become more elastic in that it's fairly easy to locate your income where there is less income tax? He used the Yellowstone Club as an example.
- 01:30:07 Mr. Haggerty said he heard the same thing on both the personal and the corporate side, but has not done research on it.

- 01:30:24 Rep. Hamilton asked about volatile natural resource revenues.
- 01:30:47 Mr. Haggerty said he has looked at this -- wealth that is extracted is reinvested into the community. He said in some states, the wealth is not being reinvested back into community but exported. He said there are ways to change the spending side of the equation so more revenue is used to reinvest in the state than provide tax breaks back to industry.
- 01:32:20 Sen. Moore said one difference Montana has is that it raises agricultural products, raw commodities. He asked if there is a different trend in states like Kansas with value-added in resources sector?
- 01:33:07 Mr. Haggerty said the more diverse the economy is, the more stable it is. He said Montana has robust growth and is in good condition. He said diversity in the natural resources sector would benefit the state, but Montana is not as dependent as we used to be or as some of our neighbors.
- 01:34:15 Chair Jones said South Dakota argues the more rural the state, the larger penetration of e-commerce. He asked if there are indications that penetration is larger?
- 01:34:55 Mr. Haggerty said he didn't know about the state level, but did know that rural areas lose retail as people commute to larger cities or shop online.
- 01:35:29 Chair Jones asked about statistics from other state's services decreasing.
- 01:36:11 Mr. Haggerty said he is looking into that question. He said there would be ongoing discussions about looking at other sectors in Montana's economy and estimating what their contribution is to GDP and estimating their contributions to total state revenue.

PUBLIC COMMENT

- 01:38:23 Bob Story, Montana Taxpayers Assoc. ([Exhibit 8](#))
- 01:48:18 Heather O'Loughlin, Montana Budget and Policy Center ([Exhibit 9](#))
- 01:51:40 Brent Mead, Montana Policy Institute
- 01:56:19 Tim Burton, Montana League of Cities and Towns
- 01:59:21 Stuart Doggett, Montana Hospitality and Lodging Association ([Exhibit 10](#))
- 02:05:41 Mike Kadas, Montana Department of Revenue
- 02:09:54 Rep. Jeff Essmann, public citizen

Recess

02:15:18 Chair Jones called a brief recess.

COMMITTEE DISCUSSION

- 02:34:09 Chair Jones called the meeting back to order and summarized some of the points brought forth by the public.
- 02:36:08 Rep. Ballance said the LFC typically compares revenue and spending charts to GDP, but if you go back in time and try to understand the causes some were intentional legislative changes or voted on by the public -- we need to understand those in various points of time to understand charts and graphs. She said each source of income will be significantly different as well. She said they had been discussing leaks as things that were new and different that they weren't capturing -- she said she had not been thinking about them as taxes that are on the books now that should be collected and are not either because they are exempted or income is not being declared.
- 02:38:41 Sen. Barrett said his sense is that if they define the problem as a failure of revenue to keep pace with economic growth, the structural factors have an impact. He said they know relatively little about the linkage. They don't know why the transition from producing goods (natural resources) to services impacts the behavior of individual income taxes. He said it's clear in other states that losing sales taxes is due to e-commerce, but it's not so clear in Montana. The linkages are complex. There are things aside from the structural changes at play. He said there are some pretty obvious answers in some cases like vehicle taxes. He said they will be looking at a basket of explanatory variables.
- 02:42:05 Sen. Moore said the flip side of economic multipliers, like the export of \$1 million in coal that goes somewhere, how do the service dollars work as a statewide perspective in the medical sector? Of \$1 million in medical supplies, how much is paid for by Montanans, how much by Medicaid/Medicare, how much does that generate in net taxable income for the state?
- 02:43:41 Sen. Blasdel said e-commerce has two different sets: how much is online sales to someone with a structural presence in Montana and how much is other entities and what's the breakdown? He asked if jobs are being contracted out rather than in-house and did that shift job numbers?
- 02:45:03 Rep. Hamilton said he's not sure how they identify the problem when they're not quite sure what the goal for the revenue system should be doing. He said they need to agree on what the revenue system is supposed to produce. He said If that's to keep pace with growth in personal income, do they agree on that? He said if they can identify the problem and then talk about solutions, how do they judge the success of the revenue system? Can they set up some future benchmarks to measure success?

- 02:46:43 Chair Jones suggested there are new players in the state. He said the goal may not be revenue increases, it could be revenue neutral, such as a reduction of property tax or some other area.
- 02:47:54 Sen. Sesso said he is learning that the focus on e-commerce might be overstated, and might not be worth it in real dollars or legally. He said it would be challenging as a non-sales tax state. He said they should take the input they received under a longer term review and analysis done by RTIC. He said if they can identify where the leakage is and capture it for the short term, the first tenant is relief of existing taxes (property, income) and will probably lead to no-net. He said with retooling they can capture where the growth is. He said there may be some earnest research they can do and get their arms around the scope of opportunity on e-commerce, if any.
- 02:51:04 Rep. Hertz said that he was not sure they can get after e-commerce or the tax gap without talking about sales tax. He said some issues, like the tax gap for individuals trying to avoid taxes, are Federal. He said he has been in business since 1989, but his segment, groceries, hasn't seen the e-commerce impact as much other retailers. He said \$1 spent in the timber industry in Western Montana significantly impacts the economy over there. He asked about \$1 spent in the healthcare industry, how much of that is trickling through economy?
- 02:53:58 Rep. Dudik said she agreed with everyone's comments. She said she would like to hear more about the inflationary impacts -- an automatic inflationary increase could earn \$111 million. She said she isn't sure why they are talking about creating new taxes when automatic inflation could solve a bit of the problem. She said other fees are not identified and it would be good to see an analysis, even if they don't go into the general fund, rather than tax new industries.
- 02:55:09 Rep. Jacobson said everyone has made good points. He said 55 percent of state revenues are based on personal income tax, but real median family income has not kept up with productivity. He said they have done a good job supporting businesses but not wages. He said if wages kept up, personal income tax collections would go up. He said he sees a failure of federal and state tax policy. He said nobody wants to talk about tax equity, they all have different philosophies on what is equitable, but he said he is concerned that whatever they do moving forward doesn't put a greater burden on the working family. He said they should encourage wage increases and ensure they don't take more money out of the pockets of working families. He said they need to look at the broad picture, is there a different way to collect revenue to meet the needs? How do we collect revenue in a completely different economy? He said somewhere along the line they have to be bold.
- 02:58:48 Sen. Moore said if the subcommittee is making recommendations to LFC and RTIC, he doesn't think they will get anywhere in a bipartisan fashion talking about total revenue benchmarks because total revenue is a function of total spend and that's what will be decided by the two-party system, the executive and voters of Montana. He said this subcommittee can try to learn more and forecast to the legislature as a whole their best guess how the tax burden will shift in time.

- 03:00:45 Chair Jones said they will have to consider gap analysis, increase in leaks, size of e-commerce, and drag/multiplier difference. He said when they define the problem, the discussion about a definition will be more of a political one. He said some will argue revenue neutrality is what you use to buy down other tax areas, others will argue for a mix of that with a revenue increase.
- 03:03:15 Rep. Ballance said she agreed. She said it is not necessarily a political discussion. She said they talked about revenue not keeping pace with gross state product, but she said the bigger problem is whether growth in gross state product is sustainable or if the revenue being collected was sustainable. She said they need to go after the underlying causes and look at trends.
- 03:04:56 Dir. Carlson said the LFD would put together information the committee would like to have more research on: value of economic sectors by type of activity and anticipated growth.
- 03:08:13 Ms. Morrison said there is a lot of work that can be done on this analysis. She said looking at other tax sources is going to be tricky, analysts will need lots of room in direction to make approximations and assumptions. She said they will need flexibility in that analysis.
- 03:09:27 Dir. Carlson said other items include: broad brush measurements on e-commerce on it's impacts.
- 03:10:20 Ms. Moore said corporate income tax collections are based on the state's share of payroll, property, and sales in Montana rather than nationwide. She said some states do double-weighted sales factors and she has outlined some of that information for RTIC.
- 03:11:05 Dir. Carlson said that idea would take you a step toward taxing internet sales more evenly than it currently is -- for example, Amazon would pay more corp tax to Montana than they presently do.
- 03:11:31 Ms. Moore said that to the extent that a company doesn't have payroll and property tax in Montana, increasing the sales factor should lead to collection of more revenue.
- 03:12:06 Rep. Jacobson asked if taxing sales was at the corporate income level? He asked if they were just passing it down to the end buyer? He asked if they were bringing in new revenue? He said it will just decrease buying power of average person.
- 03:13:10 Chair Jones clarified that a corporation was already paying taxes somewhere, why shouldn't it pay a relative portion to Montana.
- 03:13:58 Ms. Moore said the history of three-factor apportionment is a way to show how much business is happening in the state for income tax purposes and to avoid double-taxation, it is very complicated depending on where the sale is sourced, where the company is located. She said there is a lot of nuance and detail.

- 03:14:48 Rep. Ballance clarified they were talking about a way to begin to identify what the potential might be.
- 03:15:12 Sen. Barrett said he wanted to issue caution about pursuing the impact of structural change. He said suppose they correctly identified tax revenue generated by various sectors, they might see that structural change accounted for very little. He said he would anticipate it would not explain all. He said he would counsel trying to pick apart the behavior of revenue streams, corporate income tax/individual income tax and behavior. He said the relationship between structural change and income/corporate tax isn't obvious, it's the cart before the horse.
- 03:18:15 Chair Jones clarified they knew income tax haven't tracked with gross state product -- LLCs, LLPs and pass-throughs haven't been tracked.
- 03:18:43 Sen. Barrett said personal income tax grew more rapidly than economy but the relationship has declined. He said growth of corporate income tax is not keeping up with growth of the economy. He said there was a decline in elasticity. He asked what has happened to growth of personal income vs what people declare on their personal income taxes? He asked if declared income is not keeping up with growth of personal income? He asked what has happened to components of personal income that may be treated differently for tax purposes, like Social Security and those elements exempt from taxation. He asked about a shift toward capital gains and if there has been a change in the composition of income subject to taxation by tax bracket? He said the concern is they should not necessarily assume the problem is one of structural change, there may be some other factors.
- 03:22:05 Chair Jones said they've taken a look at the increase of individual income tax volatility. He said capital gains and investment income is a larger portion of income.
- 03:22:43 Sen. Barrett said if the concern is whether tax revenue is keeping up with observed economic growth, then the cash economy phenomenon does not have much explanatory power because if there is a lot of activity occurring off the books they aren't observing it in terms of taxes or economic activity.
- 03:23:57 Rep. Hertz asked Ms. Morrison about state tax revenue in relation to growth state product and asked to see other state's numbers. He said they need to look at non-labor growth as that sector is going to continue to grow.
- 03:25:17 Dir. Carlson said she and LFD staff will go through idea list and try to come up with a realistic research list for the March meeting. Also, she asked if would it make sense if the Department of Revenue could present a gap analysis for March meeting.
- 03:26:57 Chair Jones said the Department of Revenue director seated in the audience confirmed.

- 03:26:52 Rep. Ballance said the sooner they inform the rest of the committee members of the definition of the problem and the major goals for the March meeting, the better.
- 03:27:35 Dir. Carlson said she would prepare a draft agenda for a four-hour joint meeting in March.
- 03:29:18 Rep. Jacobson said they needed to keep the subcommittee meeting to four hours for March meeting or they will run into time constraints with other committee meetings.
- 03:29:42 Chair Jones thanked everyone for staying focused and not devolving into political sound bites. He said they could decide in March if the subcommittee should continue.
- 03:30:33 Rep. Jacobson asked if they wanted to bring in any other folks to be part of the discussion.
- 03:30:46 Chair Jones said they could discuss that in March.

ADJOURN

- 03:31:08 Chair Jones adjourned the meeting.