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Revenue and Transportation Interim Committee

60th Montana Legislature

SENATE MEMBERS

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KIM GILLAN--Vice Chair
JIM ELLIOTT
JEFF ESSMANN
CHRISTINE KAUFMANN
ROBERT STORY JR

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TIMOTHY FUREY
GALEN HOLLENBAUGH
MIKE JOPEK
BOB LAKE
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COMMITTEE STAFF

JEFF MARTIN, Lead Staff
LEE HEIMAN, Staff Attorney
FONG HOM, Secretary

SJR 31 SUBCOMMITTEE MINUTES

February 7, 2008

Room 137, Capitol Building
Helena, Montana

Please note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file in the offices of the Legislative Services Division. **Exhibits for this meeting are available upon request. Legislative Council policy requires a charge of 15 cents a page for copies of the document.**

Please note: These minutes provide abbreviated information about committee discussion, public testimony, action taken, and other activities. The minutes are accompanied by an audio recording. For each action listed, the minutes indicate the approximate amount of time in hours, minutes, and seconds that has elapsed since the start of the meeting. This time may be used to locate the activity on the audio recording.

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COMMITTEE MEMBERS PRESENT

SEN. ROBERT STORY JR
SEN. JEFF ESSMANN
SEN. CHRISTINE KAUFMANN

REP. TIMOTHY FUREY
REP. GALEN HOLLENBAUGH
REP. BOB LAKE

STAFF PRESENT

JEFF MARTIN, Lead Staff
LEE HEIMAN, Staff Attorney
FONG HOM, Secretary

Visitors

Visitors' list, Attachment #1.

COMMITTEE ACTION

The subcommittee did not take any action.

CALL TO ORDER AND ROLL CALL

00:00:01 Sen. Story called the meeting to order at 8:30 a.m. Secretary took roll visually and noted that all members of the subcommittee were present.

AGENDA

00:02:44 **Jeff Martin, Research Analyst, LSD**, discussed his memorandum (**EXHIBIT 1**) on Quality Schools Interim Committee School Property Tax and Nonlevy Revenue Reports. He said that the original plan was to review the reports "Disparities in School Mill Levies" and "Property Tax Information Related to K-12 Schools" at this meeting but it was decided to postpone that until the next committee meeting. Mr. Martin suggested that the committee members decide what reports they might want to look at.

00:10:19 **Office of Public Instruction - Denise Ulberg, Administrator, School Finance Division**

Ms. Ulberg gave a presentation on the Basics of School Funding (**EXHIBIT 2**).

Questions asked during Ms. Ulberg's presentation

00:15:27 Sen. Story asked Ms. Ulberg if the number on the slide showing dollar amounts for each elementary, middle school and high school district is a number that they will have for a base to build their budget on, or is it a number that they are authorized to spend? Ms. Ulberg said that it is part of what they are authorized to spend.

00:24:07 Sen. Story asked Ms. Ulberg to explain what excess reserves are. Ms. Ulberg said that at the end of the year a school district has a fund balance in the general fund and it is allowed to reserve for operations up to 10% of its ensuing year's budget. If the district collects certain revenues in that year, such as protested taxes, or tax audit receipts, or delinquent taxes, they can take those and set them aside as excess reserves. Anything over that has to be reappropriated against the next year's budget.

00:27:02 Sen. Story asked if Ms. Ulberg had an idea of what the range of those ratios are. Ms. Ulberg said that it would range from 0-100.

Sen. Story asked how many districts do not get Guaranteed Tax Base aid? Ms. Ulberg said that around 100 districts do not get Guaranteed Tax Base aid and they are the wealthier districts with higher taxable value.

00:31:53 Sen. Story asked if block grant money is included in the nonlevy revenue section, or is it counted as state money in the 62%? Ms. Ulberg said that the block grant money would be included in the nonlevy revenue section.

00:34:03 Rep. Lake asked if a reserve is allowed in the transportation budget? Ms. Ulberg said that it would be 35% in the transportation budget.

Rep. Lake asked if the district would have the authority to take the reserve money and move it into another budget item? Ms. Ulberg said that the reserve is intended to cover any budget amendments that might come up during the year. There is a law that allows them to transfer money from one budgeted fund to another budgeted fund under certain circumstances. The transportation fund is a budgeted fund.

00:37:49 Sen. Story asked why retirement funds are set up where someone in one part of the county ends up paying for the retirement programs for teachers in a district in which their students do not go to. **Madalyn Quinlan, Chief of Staff, OPI**, said that when Montana was originally settled by homesteaders they only had elementary school districts, K12 were created later across the state. In the 1930s a county high school system was laid on top of those K12 districts. There are now four county high schools and that is where the county retirement levy came from. At the time, it was retirement levy for high school teachers and not elementary teachers and now they have county retirement for all teachers.

00:43:13 Sen. Story asked what a building reserve fund is used for. Ms. Ulberg said that the building reserve fund is typically used for short-term remodeling projects, building repairs, bigger construction projects that districts don't want to go to a bond option.

00:49:19 Sen. Essmann asked if he could get a breakdown by district of the total nonlevy revenue sources and the components of those. Ms. Ulberg said that they could put that together for him.

00:52:23 Sen. Peterson asked Ms. Ulberg to explain the 1/4 over the maximum, how that excess money over the maximum is allocated and if that was in reserves. Ms. Ulberg said that the law says that districts can adopt an expenditure budget that is equal to their prior year's adopted budget or their current year's maximum.

Those districts that are overmaximum are relying on their prior year budget to be able to continue to operate. Their current year maximum probably went down because of declining enrollment.

Ms. Quinlan said that they can adopt the prior year budget going out because that is the higher of the prior year budget or the new maximum. But they have to get voter approval for any increases in property taxes. To the extent that you have declining enrollment, there is less money coming from the state and that would imply that you will have to come up with the local source of revenue. It may be oil and gas, it may be another nonlevy revenue source, but in most cases it is going to be local property taxes which requires voter approval.

Sen. Story asked Ms. Quinlan if a school district goes to the voters to approve something, are they approving a tax increase or are they approving spending authority? Ms. Quinlan said that the ballot question presented to the voters should say something like, do you support an increase in the total levy of x amount of dollars. There is some obligation in here to have a statement as part of the ballot saying, for a homeowner whose home is valued at \$200,000, that it will be so many mills.

Montana Quality Education Coalition Continuing Lawsuit

01:32:41 Lee Heiman, Legal Staff, LSD, explained that the document (**EXHIBIT 3**) is a continuation of the lawsuit that precipitated the work from last session and it asks for the court to have a show cause hearing to re-examine what has happened since the last session.

01:34:48 Sen. Essmann asked Mr. Heiman to comment on whether or not a member of the Judicial Branch would have the authority to order the Legislature into special session. Mr. Heiman said that it can only be done through constitutional methods, the Governor or the Legislature itself.

Demographic Trends in Montana - Dr. Myles Watts, MSU

01:35:28 Dr. Watts gave a presentation on Montana demographics and aging, Montana incomes and its relationship to aging, and Montana expenditures as it relates to aging (**EXHIBIT 4**).

01:54:03 Sen. Story asked what NPA stood for. Dr. Watts said that NPA stands for National Planning Association that is an offshoot of the Federal Economic Forecasting Office.

02:09:17 Sen. Kaufmann asked if the aging population was in migration? Dr. Watts said

that almost all of the people are getting older. The current estimates are that there will be an increase of at least 15% in population between now and 2030.

02:10:19 Sen. Story asked how many Montanans migrate? Dr. Watts said that recently there has been more in-migration than out-migration.

02:11:06 **Consumer Expenditures - Doug Young, MSU**

Mr. Young said that in the 1990s, they saw in-migration into Montana in every age group except for age 20-29. For the state as a whole, we saw the youngest age group, 20-29, leaving the state. Mr. Young talked about consumer expenditures. He said that some kinds of expenditures are already taxed in Montana; i.e., alcohol, tobacco, motel rooms and some other items. He talked about how the typical expenditures vary with age. Mr. Young noted that the data that he gave came from the U.S. Bureau of Labor Statistics and are national averages and are collected on the basis of households and are classified by the age of the household head.

02:31:31 Rep. Lake asked if this was national data. Mr. Young said that it was national data.

02:33:22 Dr. Young talked about Income and Consumption by Age graph. He said that it is expenditure data from a different year, on a per household basis.

02:34:10 Sen. Kaufmann asked if any effort was taken to consider internet sales or the changing consumption patterns. Mr. Young said that the data reflects the expenditures by the households not the manner in which they were purchased, whether it was mail order or internet.

02:36:26 Sen. Story said in looking at this graph, there's a big difference at the 45-54 where they say they are spending \$40,000 and they are earning \$60,000. Part of that goes into equity into their home because most of those people are buying homes. He asked if that consumption number is accurate. How is the consumption side determined, was it a survey on what they think they are spending? Mr. Young said that the data from the Bureau of Labor and Statistics involve about 7,500 households per year and are done in two separate surveys. These numbers are not perfect and part of the gap between income and consumption is taxes. The data is not perfect but the spending side is more stable with respect to age than the income side.

Public Comment on Issues Discussed

02:40:05 **Bob Decker, Policy Institute**, said that the subject of health care was not listed

as ameliorating factor. Technology decreased commitment one way or the other to health care for the elderly. It seems to him that that would be a principle ameliorating factor if in fact it's principle element of the consumer side of the equation. He felt that Medicare and Medicaid looked like they are the problem of the entitlement programs.

02:49:42 Sen. Essmann said that he would like Dr. Watts and Mr. Young to develop an accumulative graph on incomes. There is a local component and a state component. The local component is property tax, while the state component has some property tax in terms of the 95 mills but it is also has a large source of income that comes out of the general fund in terms of the general appropriation to fund the schools. The general fund largely comes out of our income taxes. In addition to the question of seniors with flat or declining incomes dealing with property taxes, if we look to the state for more support, we have a situation where in 20 years, state expenditures for Medicare and Medicaid will be drastically increasing and state income tax receipts which form the bulk of our general fund are going to be declining. That in terms of the stability of the state share of the revenue source is now in question.

Sen. Kaufmann said that the idea that somehow replacing property taxes or income taxes with a sales tax to some sort of revenue neutral position is not helping us at all.

Sen. Story asked Jim Standaert if he could show the state share of school funding among property tax, income tax, and the major sources of revenue in the general fund. He said that there is a lot of income tax going into the school system but there is also oil and gas money and some property tax at the state level. Rep. Lake asked Mr. Standaert if he could get that information and back it up a couple of years to see what that trend is. **Jim Standaert, Fiscal Analyst, LFD**, said that they could do that.

BREAK FOR LUNCH

04:35:37 Jim Standaert talked about Budgeted and Actual Oil and Gas Revenue (**EXHIBIT 5**).

Questions

04:39:16 Sen. Kaufmann asked where the revenue is if they don't budget and don't spend it. Mr. Standaert said that it turns into reserves and if it is more than the 10% of the ensuing next year's budget, it then turns into cash reappropriated. Then it goes back under the base budget in the district general fund and becomes a

revenue source in the following year.

Sen. Story asked if they can also spend some of that through budget amendment process. Mr. Standaert said that they can go through a budget amendment process and spend it that way in the year that they receive it.

Rep. Lake asked Mr. Standaert if they had a motion to go ahead and spend some of that, does that become part of their budget which would increase their budgeting authority the following year? Mr. Standaert said that they can budget amend for one year but that's only for that one year, they can't use that new higher budget.

04:40:49 Jim Standaert talked about Percent of GTB Received to fund the GTB Area **(EXHIBIT 6)**.

04:43:23 Jim Standaert talked about Statewide Enrollment 1991-2007 **(EXHIBIT 7)**.

04:44:37 Jim Standaert talked about Total School Spending per Child and Enrollment **(EXHIBIT 8)**.

Questions

04:47:01 Sen. Story asked if the chart that shows dollars per student are inflation-adjusted dollars. Mr. Standaert said that those were not inflation-adjusted dollars.

04:49:09 **Terry Johnson, Fiscal Analyst, LFD**, talked about the pie chart showing Tax Year 2001 and 2006 that reflects the income components that are actually reported on the tax returns **(EXHIBIT 9)**.

Sales Tax Background Information - Dan Bucks, Director, and Larson Silbaugh, Tax Policy Analyst, Department of Revenue

04:50:53 Dan Bucks, Director, gave policy perspective and trend perspective on the sales tax. Director Bucks said that the best days of the sales tax are past as a revenue source. The reason is it used to fit the economy and it doesn't anymore. If your tax system is not in sync with your economy it doesn't work.

05:07:22 **Larson Silbaugh, Tax Policy Analyst**, talked about Sales Tax Overview **(EXHIBIT 10)**.

Questions

05:19:37 Sen. Essmann asked Mr. Silbaugh about the range of volatility. Mr. Silbaugh said that he is not sure in terms of actual numbers, or in terms of percentages or

millions of dollars that were lost, but he can look that up.

05:20:59 Sen. Story asked if there were actual revenue losses or did the growth flatten out. Mr. Silbaugh said that he is not sure but he can look that up.

Sen. Story asked if there was any weighting that shows the different sectors and the growth rates where the retail sector is large compared to other sectors. Mr. Silbaugh said that Table 1 shows the total growth rate for those industries, not the growth rate of taxable transactions within whatever sector they are in. The retail trade is the largest sector of a sales tax.

05:24:49 Rep. Hollenbaugh asked Mr. Silbaugh if he had any idea of whether a gross receipt tax would have compliance difficulties along the lines of sales tax or would it be easier if the Department worked in collection with a gross receipt tax? Mr. Silbaugh said that many states have stayed away from a gross receipt tax because they are worried about more taxing of those business inputs. In terms of compliance it might be easier because everyone would know the definition of any receipt is taxable, but at the same time it could lead to more economic distortions than a sales tax.

05:28:38 Sen. Essmann asked why it is the assumption that the place of the sale is the location of the seller instead of the location of the buyer? Mr. Bucks said that the legal incidence of the tax is at the buyer's location, the person who purchases it because it is a tax on consumption and that fits with the philosophy of the tax. The idea of a sales tax is to tax consumption and therefore you are to tax it at the consumer level. The reason you have the seller collect it, and they are actually not collecting the sales tax because when you enact a sales tax, you enact a use tax as a backup, the use tax being the tax on the consumer for having received the good from outside the state. It is administratively impossible to get the tax from the consumer directly. The state puts the burden of collection on the seller even though the tax is legally incident on the consumer.

05:36:28 Sen. Story asked Director Bucks to give some background on offshore interstate sales, how do you reach a tax system across the U.S. border. Mr. Bucks said that whatever problems there are on the interstate basis are multiplied on an international context. In that regard, if you were to put a company and a server offshore to sell music and movies or to sell services over the internet, if there is a delivery of tangible goods, first of all you can't do it because of the Quill Case. If you can't apply it to an out of state seller, you can't apply it to an out of country seller. Even then if you solve the out of state seller problem you will have practical problems in getting the out of country sellers to comply. You can, with

goods coming into the country, there are some methods that can be used on the sale of tangible goods to potentially collect that tax which involves implicating the delivery agents in the tax and the delivery agents wouldn't like being involved. It is an extra layer of complication with the sales tax.

Sen. Story asked Director Bucks, with his understanding of Montana's economy and where it is going in light of the demographic changes, what are his thoughts on what our tax structure will look like in ten or twenty years? Mr. Bucks said that in reflecting on these sources of taxation and different kinds of taxes, the most adaptable tax to an economy that is either goods-based or service-based, knowledge-based or manual-based, is the income tax. It is the one that can be made to work the best. The property tax has been around for centuries and it has strengths and weaknesses. It will always be there as a stable source of revenue, but his own view is that the income tax is the most durable and adaptable type of tax for the future.

05:42:40 Rep. Lake said that looking at the challenge within this particular issue and the funding of an education system for Montana and that we must provide our young people with an education, he asked Mr. Bucks where will the base for the funding going to come from? Mr. Bucks said that the short answer is to make the income tax work better in practice.

05:53:08 Sen. Essmann asked about an idea of a departure tax. Mr. Bucks said that there would have to be some careful examination of the constitutional issues there.

Public Comment

None given at this time.

05:56:33 **Streamlined Sales Tax Project - Lee Heiman, Legal Staff, LSD**

Mr. Heiman talked about the Streamlined Sales Tax Project that the committee has been hearing about (**EXHIBIT 11**).

06:03:30 Sen. Kaufmann said that if a church goes to Wal Mart to buy supplies, do they pay the tax? Mr. Heiman said that that is up to the state. When you draft a bill, you can decide that churches are tax exempt. Indian tribes, the federal government, the state and municipal governments are tax exempt and they apply to be exempt and are given a number which they provide at the time they make a purchase.

06:04:43 Sen. Essmann said that a question was raised as to how to avoid taxing business inputs. Mr. Heiman said that at the time you put together the sales tax,

you decide what kind of business inputs that you don't want to tax. Any business entity has to register what is not taxable because it is an input.

06:10:56 Sen. Story adjourned the meeting at 2:41 p.m.

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