

COMMENTS ON MONTANA'S TREATMENT
OF CORPORATE INCOME TAXES
December 20, 2006

I appreciate the opportunity to discuss a question which was originally raised by Professors Jack Morton and Michael Harrington of the University of Montana in the "Economic Outlook Seminars" held earlier this year. The main question these gentlemen asked Montanans is: "Are We Open for Business" ?

In trying to answer this question, Morton and Harrington made a comparison of Montana's business sector with those in our surrounding states. They wondered why Montana hasn't attracted large firms like Albertson's, Hewlett-Packard, Micron Technology, Washington Group, and J.R. Simplot in Idaho; or Citibank's national credit card operations which have substantially benefitted South Dakota. Their reasons why these Fortune 500 companies moved to Idaho and South Dakota included changes in the laws which made them more "hospitable" to business.

I'm a native Montanan. I live and practice law in Helena. I've represented a number of companies in tax disputes with the state of Montana over a period of almost 49 years. I'd argue that Montana isn't really "Open for Business". I think that corporate tax policy is one of the problems. In my experience, Montana tax policy has caused some of my clients to relocate their operations to other states. I sincerely believe a review of these tax policies should be part of an honest examination of Montana's economic situation.

Most public policy decisions have consequences. Montana's recent "policy choices" have not been favorable to natural resource development. In spite of this, we have a looming state budget surplus of close to a billion dollars. This is said to be caused by high world wide

demand for copper, oil and gas. High prices "offset" the added costs of Montana's environmental policies. My intent is not to dispute the reasons for these policies, but to ask listeners to recognize that those policies have an effect on business location decisions by people considering investments in Montana. Policy choices have long term effects. Our choices will still be there long after the prices for natural resources return to lower levels. We should understand that our present "Tax Windfall" might not last very long. Many of our legislators recognize this reality because they come from ranching and farming backgrounds . World wide market prices deeply effect our farmers and ranchers.

Because of Montana's historical "boom and bust" cycle , there is a need to re-examine all our tax policy choices. Are we sincerely interested in making Montana a favorable place for long term investment? Are we really interested in changing from a "boom and bust" cycle to a more stable business climate? Tax policies affect many more businesses than those related to natural resources. We need to consider choices which affect corporate decisions to either enter Montana or to remain here.

Montana has a law known as the Uniform Distribution of Income for Tax Purposes Act. This law was originally intended to allow states to collect the state's proper taxes on profits from the activities which occur here. This law was intended to give Montana a fair tax share in wealth that was created here. In a proper case it works that way. My objection is that Montana's tax collectors have gone too far in reaching for a share of "out of state" income. The justification they use to get at this out of state income is a subjective concept known as "strong central control". They believe that if a company has a central office, which sets general policies, exercises executive oversight, uses central accounting systems, or has a central retirement and

health insurance plan for the employees of all of their subsidiaries, then “presto”, the company is “unitary”. Then all of its income wherever it is produced is taxable in Montana, regardless of whether its activities in Montana make any real contribution to its activities in other states.

Common ownership of all the parts of the company is all that is needed. You may believe this sounds like a “neat” idea, but if you’re a company which makes “widgets” in Pennsylvania and is considering making “gadgets” in Montana, this tax policy will make you think very hard about Montana as the place to invest your money.

So what’s wrong with this policy? Well, there are federal laws and some state laws that make “strong central oversight” a legal requirement. There are people who are now in prison, and companies that have been bankrupted because they didn’t exercise proper “oversight and control” of all of the company’s activities. For example, Congress passed the Sarbanes-Oxley Act to require strong financial oversight by executives and personal verification of accounting reports by these people, on pain of prosecution. There are also employment laws which require standardized treatment of employees with respect to compensation, health benefit plans and retirement. The Federal Securities and Exchange Commission requires publicly traded companies to make formal reports, which inform markets, stockholders, and regulatory agencies of what they are doing. Thus, the effect of Montana’s tax “strong central control” tax policy is to penalize companies for complying with other state and federal laws. Montana pulls in more taxes just because businesses are obeying the law. This hurts companies presently doing business here, and scares away those businesses considering Montana.

Many states are now studying ways to tax the profits of “high technology companies”, the internet companies. Determining how and where they make their money is often a difficult

problem. Traditional "bricks and mortar" companies have a tough time competing. Montana's unitary tax policy further discriminates against these traditional businesses by making "strong central control" a basis to tax out-of-state activities which have no functional connection to Montana, except cash flow to the stockholders.

From my viewpoint, this is a good reason to question whether our state is really "Open for Business". Are we really interested in attracting businesses to Montana? If so, we should take a hard look at whether our tax policies support that message or send a message that is exactly opposite.

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