

**Testimony to the Montana Senate Finance and Claims Committee on HB 2**

**Montana Department of Revenue Budget**

**Dan Bucks, Director of Revenue**

**March 21, 2011**

I wish to thank Chairman Beck and the General Government Subcommittee, especially Senators Olson, Buttrey and Wanzenried, for their study of and attention to our budget. I would also like to thank your staff, Greg DeWitt and Budget Office staff Mark Bruno, for their assistance and support for this process.

The Department of Revenue is responsible for more than \$2.6 billion in state and local revenue each year. We have more contact with more citizens and businesses than any other state agency. The product we produce—revenue . . . money in the bank—is the lifeblood of Montana state and local government. Yet, we have a much smaller staff than several other state agencies. Over the last two years, we set records for audit collections—as a result the 2011 Legislature meets with \$150 million more in the state treasury than would otherwise be the case—\$150 million more that you can devote to the public purposes you choose. Given the importance of our work, our record of achievement, and our responsibilities to the public this budget should be properly funded as proposed in the Executive Budget. HB 2 as approved by the House of Representatives shortchanges the citizens of Montana.

These remarks highlight the financial return on investing in the Department's work. However, please note that our work also creates fairness among taxpayers, a level tax playing field among businesses for economic and job growth, and public trust in and respect for the law.

Cutting the Department's budget by \$6.1 million from the Executive Budget level, as recommended by the House, does not make sense in these times. It does not save you money, it costs you \$36 million in lost state revenue because you will reduce the ability of the Department to collect revenues due and owing under the law you enacted by 6 times what you cut. That is a conservative estimate based on years of analysis and actual experience. The LFD staff analysis says the loss is 3.5 times what you cut. For the purpose of setting this Department's budget, it makes no difference which of these two numbers or anything in between that you choose. The analysis of both your staff and the executive branch reaches the identical result: **cutting the budget loses you more than you gain**. Restoring the Department's budget does the opposite—it pays for itself several times over in properly collected revenue. It is a settled question that investing in the Department of Revenue yields a very high, positive rate of return.

How high is that rate of return on the investment compared to other financial returns? In December 2009, we reported to the Revenue and Transportation Committee a comparison

between the rate of return on compliance work by the Department of Revenue over a five-year period from 2005 through 2009 and the rate of return by the Board of Investments on the Short Term Investment Pool. Our net return over cost was 180 times the return on the Short Term Investment Pool. Hands down—there is no better investment for public funds than the Department of Revenue.

There is another benefit to our tax compliance work. Non-residents and out-of-state corporations represent about 10% to 11% of our taxpayers. However, they pay about 50% of our audit collections. Much of our compliance work returns money to circulate here in the Montana economy that should never have left the state.

So far we have only talked about state revenues. HB 2 in its current state will also reduce local property tax bases resulting in an additional \$30 to \$40 million of local government and school revenue lost or shifted to existing property taxpayers in the form of tax increases. That impact will occur because this budget will force us to hold open 17 property tax jobs across the state. We cannot value property without sufficient staff to do so. Every option we would have in response to a budget cut of this size will cause damage to the local property tax system. The least damaging option would involve delaying the annual work on valuing new construction such that only about 20% to 25% will be picked up each year. 75% to 80% of the new construction in any given year will not be valued and will go untaxed—with those taxes shifted to existing properties. Given how local budgets are set under state law, the cuts to the Department's budget will translate into property tax increases that will likely total in the tens of millions of dollars for owners of existing property—homeowners, small businesses and farmers and ranchers. In addition, anticipated revenues from growth for tax increment financing districts will be significantly curtailed.

A number of other states faced with even greater revenue challenges than Montana have made the choice in the last few years **to increase their tax agency budgets** to improve revenue collections. Last year, Idaho approved 48 new tax agency positions. So far the revenue Idaho has earned is double the target they set for that budget action. The decisions in other states to expand tax agency budgets have returned a yield ranging from just below 6 to 1 to a high of 13 to 1. Here in Montana in 2005, the Legislature approved eight staff positions in the Department for enhanced tax compliance. In the first biennium of the appropriation, the return was 10.5 to 1, and in the second biennium the return was 14.7 to 1. In contrast, a handful of other states cut their agency budgets and saw losses ranging from 5 to 1 to over 15 to 1. All of the available evidence shows that when states—including Montana—have increased tax agency budgets, the result pays for itself several times over and often much more than by a 6 to 1 ratio. That is why the Executive Budget includes a modest decision package to add eight staff to increase revenues in the next biennium. That decision package will help address the backlog of 110,000 non-filer and non-compliance cases that our agency has identified, but is not able to address with current staff.

The \$6.1 million the House cut from our budget will end up—if not restored—in the Short Term Investment Pool earned about 3.5% last fiscal year. At that rate if the monies are placed in the pool, the general fund will gain about \$320,000 in interest for the 2013 biennium. If you invest that same \$6.1 million with Department in the next biennium, you will net \$30 million after subtracting the cost of the investment—or nearly 100 times as much. So the House version of the Department’s budget shortchanges Montana citizens a hundred times over.

The Legislature functions as a Board of Directors for the public funds that belong to the citizens of Montana. Doesn’t the Legislature have a fiduciary responsibility to Montanans to maximize the return on those funds? Doesn’t \$30 million of restored revenues or even \$10 or \$15 million as compared to \$320,000 of interest earnings make a compelling case for restoring the Department’s budget? Doesn’t the Legislature have a responsibility to prevent a disruption of local property taxes that will either strain local governments and school district budgets or confront the owners of existing property with tax increases through an unfair shift of taxes? And doesn’t the Legislature have a responsibility to see that taxes owed under the law are actually paid so that diligent, honest taxpayers do not lose out to those who neglect, ignore or evade their tax responsibilities?

Last Friday, this committee conducted a dialogue with Budget Director Ewer about the future of Montana’s finances. Director Ewer expressed optimism about that future. Some committee members expressed a different view. The word “scary” even came up. Later this committee began to consider the health and human services budgets and the education budgets. Again, the discussion was about helping people lead more healthy and productive lives in the future and about preparing our children in school and young people in college to face that future. Then the process of making choices began. Beyond the individual choices, there was an overarching choice facing this committee—a choice between shrinking from the future out of fear and uncertainty or shaping the future with realistic confidence. Underlying that larger choice is the question some of you have raised about whether the money will be there to shape the future. As Director Ewer stated if you count the money coming in during this year of recovery, the money is there. But you will undermine that reality if you consciously cut the Revenue Department budget. If you restore this Department’s budget, the money will continue to be there. Still more revenue will be there if the Legislature enacts the tax fairness bills recommended in the Executive Budget that ask out-of-staters to pay their fair share of Montana taxes. Restoring the budget of the Department of Revenue provides you the opportunity to restore your confidence that the money will be there for shaping the future of Montana.

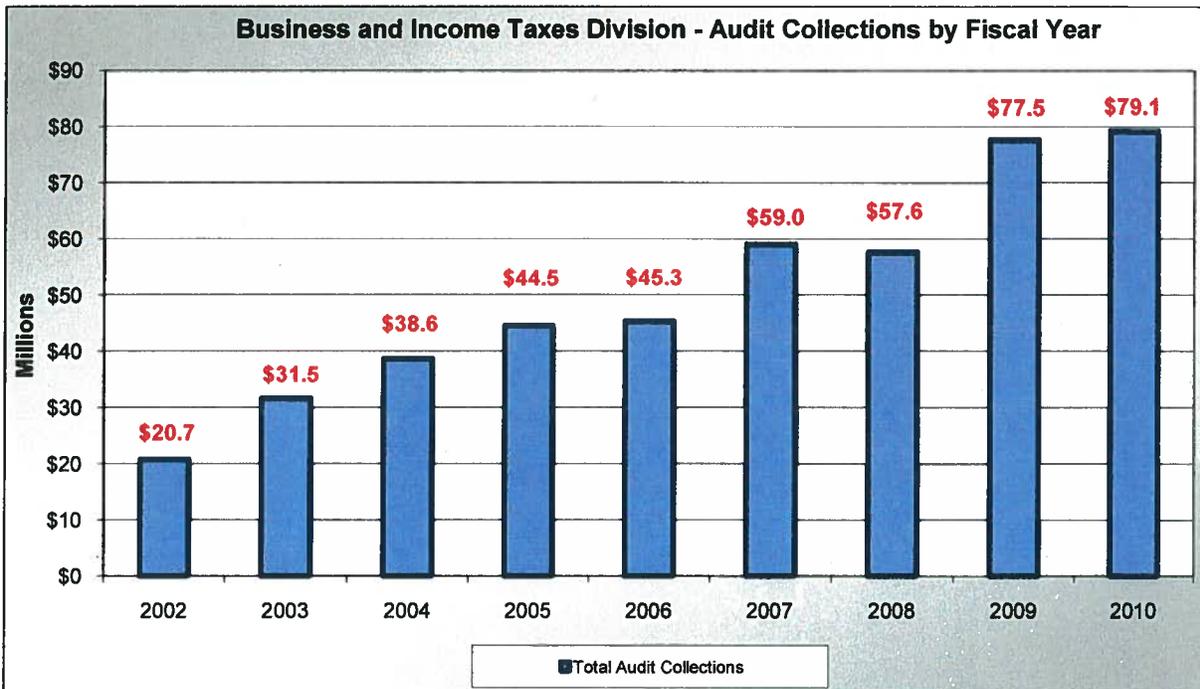
Reducing the Department’s budget in any area will reduce the service we provide—state and local revenues. The revenue you lose is several times the budget cost. The policy choice that makes fiscal and economic sense for Montana is to restore the Executive Budget levels for the Department of Revenue by reversing the 5% budget reduction, funding the full maintenance cost for our new imaging system so that the state does not waste a \$3.2 million investment, and to approve the decision package to enhance equitable tax compliance. **Our work pays for itself**

**several times over in better revenue collections, supports a stronger economy through a level tax playing field among businesses and creates greater trust of our citizens in the fairness and integrity of our tax system.** Restoring the Executive Budget for the Department of Revenue will restore \$36 million to 2013 biennium revenues—for a net gain in fiscal balance of \$30 million for the citizens of Montana.

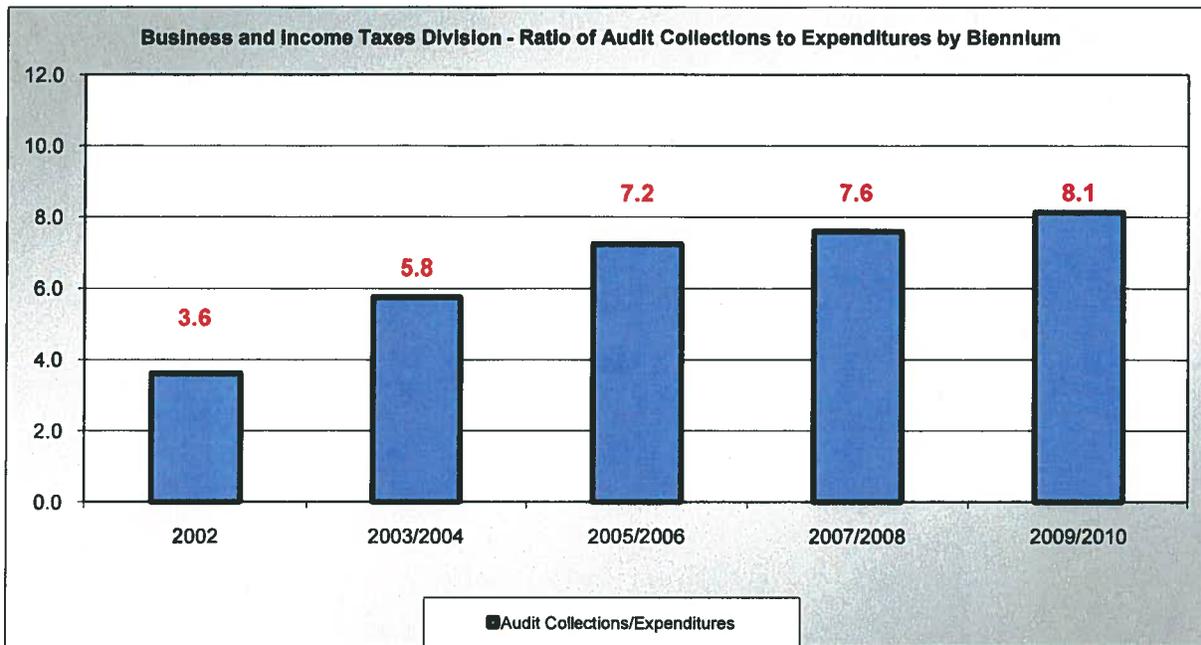
## Overall Results of Montana Department of Revenue (DOR) Increased Compliance Efforts

Montana's recent compliance efforts have yielded increased tax collections. For each dollar the Montana Legislature has invested in compliance efforts, the DOR has returned from \$8 to almost \$15 in increased tax collections.

The table below demonstrates how effective investing in compliance efforts has been.



The second table (see next page) illustrates the overall return on investment the DOR has experienced with its compliance efforts. This ratio takes the audit collections from the above table and divides it by the amount that was appropriated for the Business and Income Taxes Division for each biennium. The overall return on investment of the Business and Income Taxes Division is lower than the marginal return on investment, which measures just the collections and expenditures of specific compliance programs.



**What are the benefits of better tax compliance?**

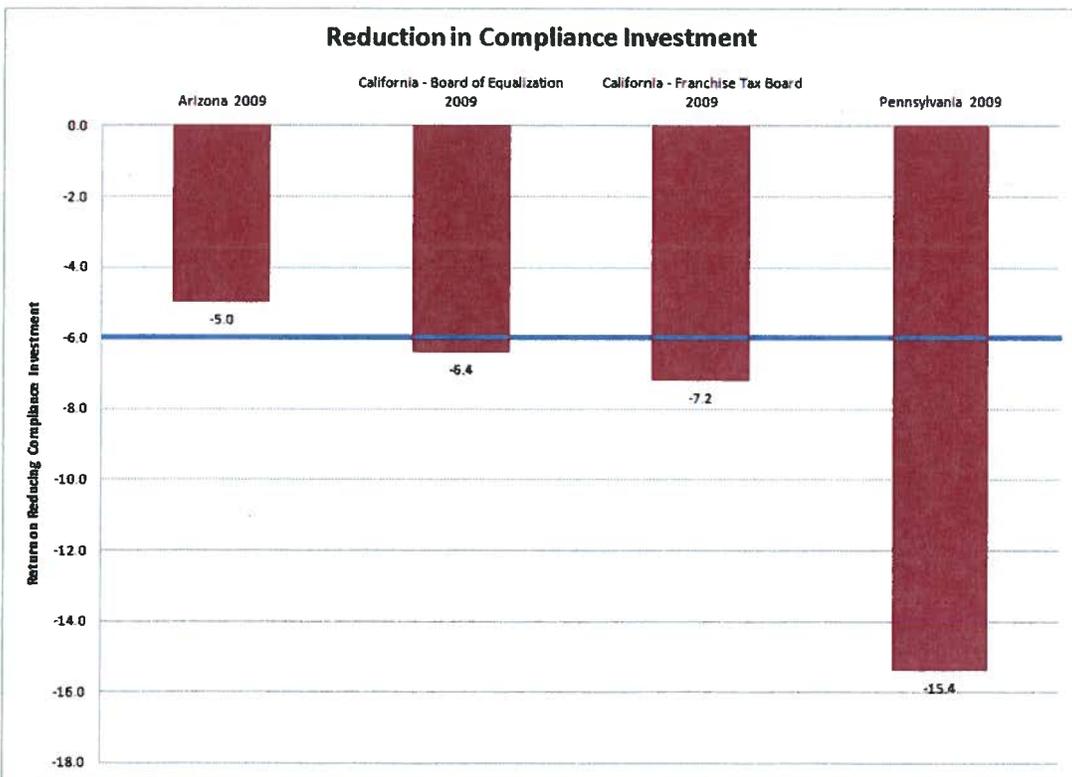
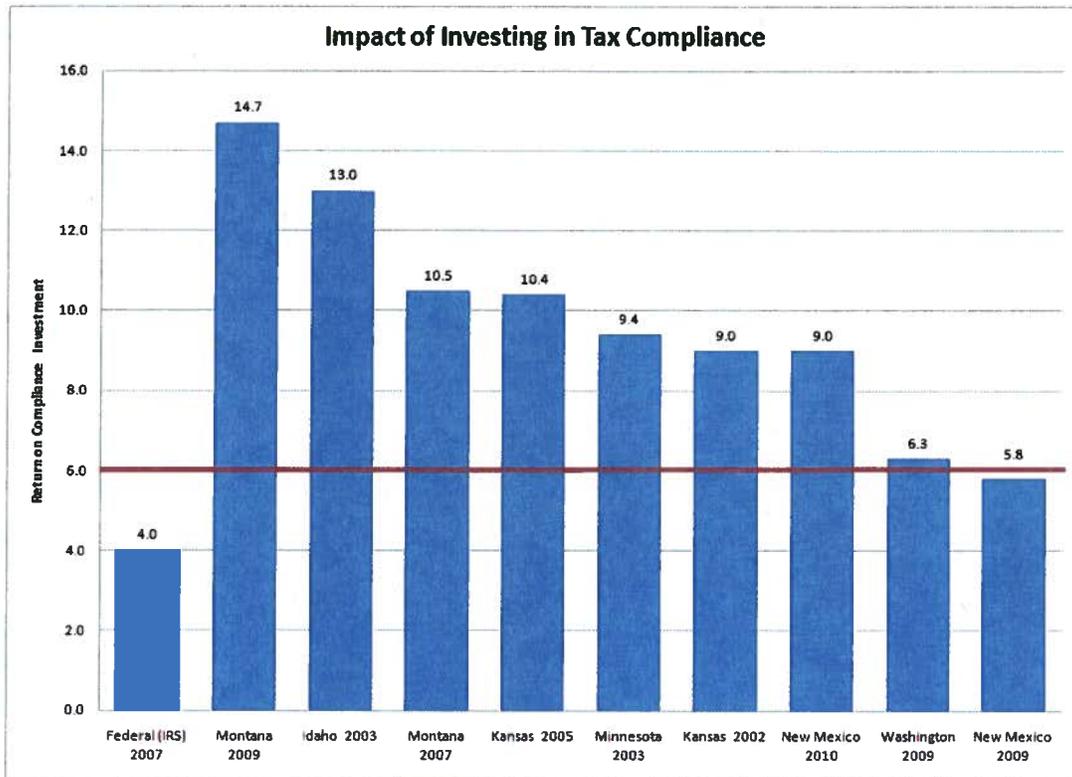
**Fairness in Taxation:** Honest and diligent taxpayers who pay the right amount of taxes on time are protected from having to pay even more taxes to make up for those individuals and businesses not paying their fair share under Montana law.

**A Stronger, Growing Economy:** The Montana economy grows on a sustained basis if taxes are equalized so that businesses compete on a level playing field and if proper revenues are returned from out-of-state to flow through this state once again.

**A Brighter Future for All Montanans:** The future for all Montanans is improved through efficient public services, solid infrastructure and investments in education for higher paying jobs.

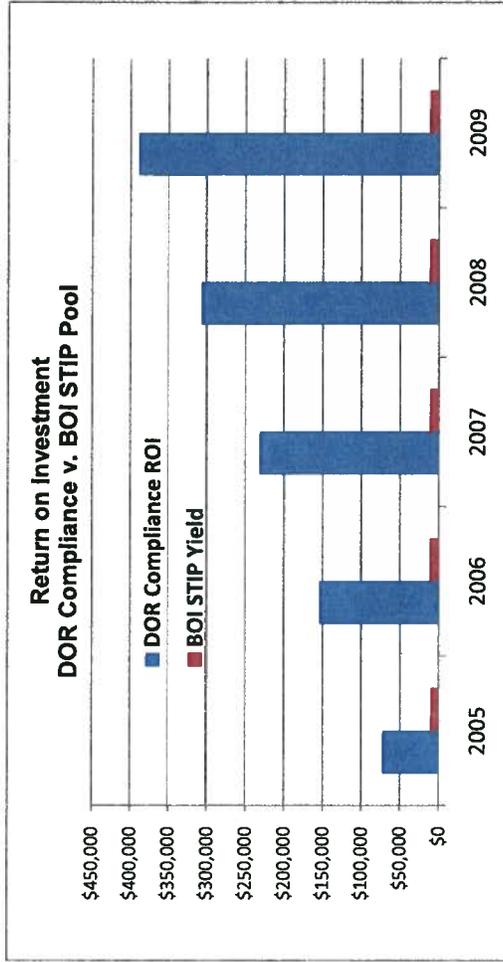


# Montana Department of Revenue



## Comparison of Financial Results for DOR Compliance and Short-Term Investment Pool

DOR Compliance				STIP Yield				
Calendar Year	DOR ROI	Annual Investment	Returns During Year	Cumulative Returns	Calendar Year	Annual STIP Yield	Balance at Beg. Of Year	Balance at End of Year
2005	7.2	\$10,000	\$72,000	\$72,000	2005	3.27%	\$10,000	\$10,327
2006	8.2	\$10,000	\$82,000	\$154,000	2006	4.80%	\$10,327	\$10,822
2007	7.7	\$10,000	\$77,000	\$231,000	2007	4.79%	\$10,822	\$11,340
2008	7.5	\$10,000	\$75,000	\$306,000	2008	2.98%	\$11,340	\$11,678
2009	8.3	\$10,000	\$83,000	\$389,000	2009	1.74%	\$11,678	\$11,881
<b>Net Return to General Fund:</b>				<b>\$339,000</b>				
<b>Ratio of DOR Return to STIP Return:</b>				<b>180 to 1</b>				
					<b>\$1,881</b>			





Dan Bucks  
Director

# Montana Department of Revenue



Brian Schweitzer  
Governor

## MEMORANDUM

To: Senate Finance and Claims Committee

From: Dan Bucks, Director

Date: March 21, 2011

Subject: Frequently Asked Questions about Department Budget Ratio of Expenditures to Revenue Collections

**Is it a significant conclusion by the Legislative Fiscal Division Staff that there is indeed a multiplier effect related to the Department of Revenue budget?**

Yes. This conclusion clearly establishes that in Montana it is a settled question that the Department of Revenue's budget does the following:

- Investing in the Department's budget returns more revenue than the expenditure costs, and
- Reducing the Department's budget costs more state revenue than is saved.

**Is the marginal difference in the multiplier used by the Revenue Department as compared to the Legislative Fiscal Division for estimating the impact of changes in the Revenue Department budget relevant to making decisions on that budget?**

No. Both numbers are significant, positive numbers and, in either case, an increase in the budget more than pays for itself several times over in additional revenues, and a decrease in the budget costs more state revenue than it saves in the expenditure reduction. The DOR multiplier is 6 (1 dollar of budget change yields 6 dollars in revenue change). The LFD multiplier is 3.5. (See page 5, next to last paragraph of LFD analysis.)

**Is there a time when the size of the multiplier is relevant?**

Yes. The multiplier size, as long as it is positive, is not relevant to setting the Department of Revenue's budget, but it is relevant to other subsequent budget decisions for other programs. After the Legislature would choose to increase the Department's budget, the Legislature would likely want to make an accurate estimate of the revenue dividend from that action so that it could decide how much, if any, of that dividend it wishes to spend on other policy choices.

### **Why is the Department's multiplier estimate different from the LFD's multiplier?**

The Department's multiplier estimate is based on an analysis of complete data for the Department and all of its functions. It relies upon empirical data from actual experiences over the last decade with regard to tax agency budgets in Montana and other states, draws upon academic research on tax compliance returns, and considers the backlog of 110,000 non-filer and non-compliance cases for which the Department does not have sufficient staff to address.

In contrast, the LFD makes only a partial analysis of the Department's revenue results, leaving out important sources of revenue collections. The LFD analysis also does not utilize any empirical data on tax compliance results in Montana or other states, nor does it address academic research on this topic.

### **What revenue streams are left out of the LFD?**

The LFD left out voluntary state tax compliance revenues as well as property tax revenues and costs from its analysis. The Department increases voluntary compliance through services to taxpayers, effective processing functions and the deterrent effect of its audit and collections activities. Changes in the budget for these functions alter the voluntary compliance results.

Further, the LFD analysis fails to account for the fact that no property tax dollars are collected except through the Department's direct action. The LFD analysis does not appear to understand the central role that the Department plays in the valuation and collection of every dollar of property tax revenue in Montana.

### **What is the effect of the LFD leaving out these revenue streams from the analysis?**

It understates the multiplier that predicts the effect of tax agency budget changes on revenue results.

### **How do both the Department's and the LFD's multipliers compare to the empirical evidence from Montana and other states?**

The Department's 6 to 1 multiplier is consistent with, but on the conservative side, of the empirical data from other states. The LFD's 3.5 to 1 multiplier is much lower than empirical data from several states and not consistent with any of the results. In fact, the lowest multiplier measured in any state in recent years is 5 to 1. In the vast majority of cases, the multipliers are higher than 6 to 1 and, in a couple of cases, extend into the 13 to 1 and 15 to 1 range. So the Department's estimate is a much better "fit" with the empirical data and is a much clearer reflection of the actual role the Department plays in both state and local government revenue collections.